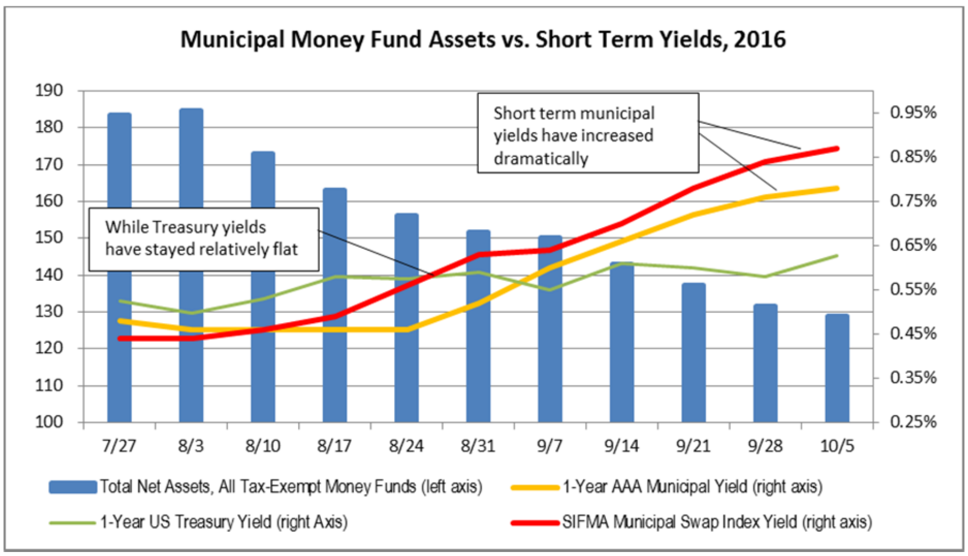
## BPG Fixed Income

# Changes in Money Market fund regulations have caused Short-Term Muni yields to spike

Sweeping changes in government regulation of Money Market funds have caused a substantial shift in reserve assets from Prime and Municipal Money Market funds into Treasury or Federal Agency funds. In Municipal funds, more than $50 billion has been withdrawn in the past three months alone, according to the Investment Company Institute (see chart below). To meet these staggering redemptions, funds have been selling short-term holdings, causing prices to fall and yields to rise by approximately 30 bps over the last few months.




Source: Bloomberg, Thomson Reuters TM3, ICI

Under new SEC regulations, Prime and Municipal Money Market funds are required to adopt floating net-asset values and impose liquidity fees and redemption suspensions under strained market conditions. Investors have shifted into Treasury or Federal Agency funds that are exempt from the new rules. Funds have been forced to liquidate holdings to meet redemptions, causing prices to fall and yields to rise.

As short-term rates have risen in the municipal market, the difference in yield between one- and five-year maturities has decreased by about 10 bps, flattening the yield curve and making shorter maturities more attractive. Further, the selloff in short-term municipals has moved their yields even higher than comparable maturity US Treasury yields by about 15 bps, as of October 5. For tax-exempt bond buyers who benefit, the after-tax yield is even more advantageous.

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Part of this short-term municipal selling has been in the “bread and butter” holdings that Municipal Money funds use for liquidity, Variable-Rate Demand Notes (VRDNs), which have cheapened significantly. VRDNs are securities that typically have a longer-term final maturity and “for which the interest rate resets on a periodic basis and holders are able to liquidate their security through a ‘put’ or ‘tender’ feature, at par,” according to the MSRB. This put or tender feature allows VRDNs to be money market fund-eligible, considered under SEC Rule 2a-7 as having a maturity equal to the next put or reset date rather than their final maturity date. Additionally, virtually all VRDNs benefit from third party credit and liquidity enhancements, including letters of credit and standby purchase agreements, both of which are typically provided by a highly rated financial institution. Yields on VRDNs are typically based on the SIFMA Municipal Swap Index Yield, which has almost doubled in the past three months.

Given this relative value, we have begun tactically purchasing VRDNs and short maturity municipals in our Core Municipal Short Duration and Tax Responsive Short Duration strategies. Also, as Stifel and other banks have indicated a change in Money Fund sweep vehicles to Treasury or Federal Agency funds for all accounts, we have moved eligible cash balances in other Core Municipal and Tax Responsive strategies into these securities.

We believe this may be a unique opportunity to reconsider short-term municipals.

*The BPG Group at Ziegler Capital Management, LLC actively manages Core Municipal, Tax-Responsive, and Core Taxable Strategies. Our approach balances a client’s objectives – income, risk, capital preservation, and appreciation – rather than focusing on an income target without measurement of relative risk.*


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## DISCLOSURES




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