GRANT'S
INTEREST RATE OBSERVER®
Vol. 34, No. 20b | Two Wall Street, New York, New York 10005 • www.grantspub.com | OCTOBER 28, 2016

No yield for you

Three-month Libor continues to hover at post-crisis highs—88.57 basis points on Tuesday, up from 32.3 basis points one year ago. Yet prime institutional money funds, investors in Libor-like instruments, show average seven-day yields of 29 basis points.

If you are looking for someone to thank, Mr. or Ms. Yield-Starved Cash Hoarder, you may thank the U.S. government (*Grant's*, July 29). In advance of the Oct. 14 deadline for implementing federally mandated money-fund protocols, investors pulled $1.15 trillion from the kinds of funds that hold commercial paper, certificates of deposit and other private (and municipal) instruments. Just about all of this vast stash they redirected to U.S. government money funds. The switcheroo must stack up as one of the greatest money migrations of all time.

Why haven't the surviving prime funds begun to offer yields more closely tethered to Libor? For one thing, they've stopped waiving management fees (when you yield nothing, you can't charge much for stewardship). For another, the funds have been in anticipatory damage control since the regulatory orders came down. They have shortened maturities and husbanded liquidity to protect against catastrophic withdrawals. Now that the worst would appear to be over, they can resume managing for yield instead of survival.

"Libor rates are just starting to be reflected in money funds," Peter Crane, president and CEO of Crane Data, tells colleague Harrison Waddill. "Money funds couldn't take advantage of rising Libor because they were causing the Libor spike—shortening their maturities ahead of the October 14 reform deadline. Now that deadline has passed and they can be relatively comfortable that all the rest of the money in prime funds isn't leaving immediately, they're beginning to extend and you've seen yields start to move out."

So far, the rate of rise is—to put the best face on it—stately. In the past three weeks, the seven-day average yield on prime institutional funds has risen by one basis point, to the aforementioned 29.

Are there, then, no money-like income oases? Some talk up the opportunity in short-term municipal bond funds (holders of securities maturing in five years or less), and, yes, they do offer yields closer to Libor than to the 0.33% three-month Treasury bill rate.

The Wells Fargo Short-Term Municipal Bond Fund Class A (WSMAX), for instance, delivers a 30-day yield of 82 basis points, for a tax-equivalent yield of 126 basis points to the 35% tax bracket. The fund has an average maturity of 1.6 years and boasts an investment-grade rating on 90% of its assets.

Addendum: Between March 31 and Dec. 16, 2008, the fund suffered a 5.5% drawdown. There still ain't no free lunch.

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