TheINVESTOR
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TheNEWS

Is Your Local Government Ready to Ride the Next Wave?

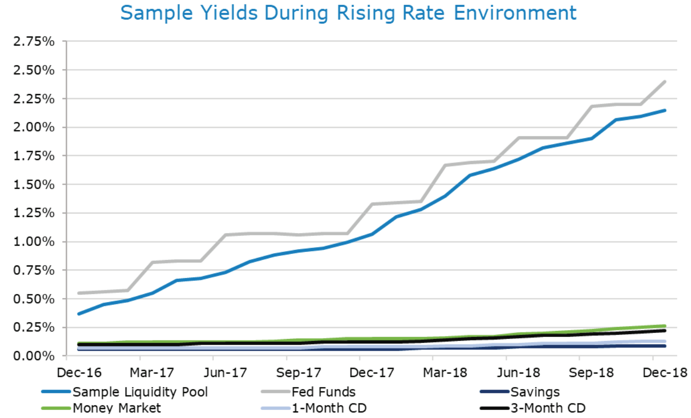
Managing Liquid Cash

In 2017, short-term liquid investment pool participants were excited and ready to take advantage of the first rising interest rate environment in nearly a decade. While the Fed raised rates once in December 2015 and again in December 2016, they began rapidly raising historically low interest rates at the start of 2017; by the end of 2018, the Fed had raised rates a total of nine times over the period, making short-term investors happy with materially higher yields on their investments. Unfortunately, the Fed reversed course in the second half of 2019 and in March of 2020 at the start of the COVID-19 pandemic when the Federal Open Market Committee (FOMC) dropped rates by 150 basis points. The Fed's interest rate policy, as well as the economic downturn resulting from the pandemic, has effectively kept short-term rates near zero ever since.

As the economy continues to show signs of recovery and the Fed adopts a more hawkish tone, liquidity pool participants are now well-positioned to take advantage of upcoming rising rates once again. Given the short average maturity of pool investments, liquidity pool yields can adjust rapidly and provide a current market rate. As holdings in a liquidity pool mature, fund managers invests these proceeds into high yielding securities thus providing investors with a more current (and higher) market rate. Many liquidity pools performed very well during the last rising rate environment, closely mirroring changes in the Fed Funds Rate, resulting in yields that were well above bank deposit rates.

One reference rate that investors use to determine how liquidity pool yields will behave is the Fed Funds Rate; this is the interest rate at which banks and other depository institutions lend money to each other, usually on an overnight basis. It is an excellent benchmark for short-term interest rates. Unlike bank deposit products, stable net asset value liquidity pools quickly adjust to upward movements in market interest rates. The chart below shows the growth of the Fed Funds Rate, as well as sample liquidity pool rates, during the last rising rate environment when the Fed Funds Rate moved from approximately 0.50% to almost 2.50% over the course of two years. Conversely, various bank deposit rates only moved from about 0.00% to approximately 0.25% over the same period.

Sample Yields During Rising Rate Environment



Source: FDIC, Federal Reserve Economic Data, and Public Trust Advisors, LLC

While no one can say for sure when short-term interest rates will begin to rise, the FOMC recently announced it will begin winding down its asset-purchase program in November of this year, presumably the first step towards an eventual rate hike next year. With inflation still running well above the Fed's 2.00% target, the market currently expects the first rate hike to occur around the third quarter of 2022.

Now is a great time to consider allocating liquid funds from bank accounts to the VIP Stable NAV Liquidity Pool so your entity can take advantage of the next rising rate environment.

For more information on how to best navigate your entity's cash mangement in a rising interest rate environment, please contact us at info@valocalfinance.org!

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Virginia Investment Pool
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TheECONOMY

A Transitory Problem?

Inflation continues to be front and center in the economic narrative with the reading for October continuing to add fuel to the fire; the consumer price index (CPI) month-over-month change came in at +0.9% while the year-over-year change came in at +6.2%, the highest annual pace since 1990. The increase in CPI was broad-based with energy, shelter, food, and used cars leading the way. Continued inflationary pressures will be a key metric to watch over the coming months as the market tries to assess whether higher inflation is transitory, as the Federal Reserve expects, or whether it is persistent and, therefore, demands action from the Fed.

Nonfarm payrolls rebounded in October, coming in at 531k jobs added versus expectations of 450k. Two-month net revisions were also positive at 235k, helping to offset weaker-than-expected readings for both August and September. The unemployment rate also beat expectations, coming in at 4.6%. This is an improvement of 0.2% from September and a vast improvement from the start of the year at 6.7%. While Chairman Powell indicated in his most recent press conference that we are still not at maximum employment, he stated that we could be on pace to hit maximum employment sometime next year if job gains remain strong.

The Federal Open Market Committee (FOMC) kept the Federal Funds Target Rate stable at the November meeting, but they did announce that they will begin to taper asset purchases starting this month. To start, they will reduce the monthly pace of net asset purchases by $10 billion for Treasury securities and $5 billion for agency mortgage-backed securities in November and December. After December, the pace of tapering is variable and subject to economic conditions. The market currently anticipates that the FOMC will begin to raise the Federal Funds Target Rate in the second half of next year.

Treasury Yields

MATURITY	11/9/21	10/8/21	CHANGE
3-Month	0.041%	0.046%	-0.005%
6-Month	0.056%	0.056%	0.000%
1-Year	0.127%	0.089%	0.038%
2-Year	0.421%	0.318%	0.103%
3-Year	0.726%	0.580%	0.146%
5-Year	1.081%	1.060%	0.021%
10-Year	1.436%	1.612%	-0.176%
30-Year	1.818%	2.164%	-0.346%

Source: Bloomberg

Agency Yields

MATURITY	11/9/21	10/8/21	CHANGE
3-Month	0.061%	0.044%	0.017%
6-Month	0.075%	0.055%	0.020%
1-Year	0.116%	0.088%	0.028%
2-Year	0.439%	0.316%	0.123%
3-Year	0.725%	0.601%	0.124%
5-Year	1.097%	1.061%	0.036%

Source: Bloomberg

Commercial Paper Yields (A-1/P-1)

MATURITY	11/9/21	10/8/21	CHANGE
1-Month	0.080%	0.080%	0.000%
3-Month	0.140%	0.100%	0.040%
6-Month	0.200%	0.140%	0.060%
9-Month	0.250%	0.160%	0.090%

Source: Bloomberg

Current Economic Releases

DATA	PERIOD	VALUE
GDP QoQ	Q3 '21	2.00%
US Unemployment	Oct '21	4.60%
ISM Manufacturing	Oct '21	60.80
PPI YoY	Oct '21	12.50%
CPI YoY	Oct '21	6.20%
Fed Funds Target	Nov 12, 2021	0.00% - 0.25%

Source: Bloomberg