FLORIDA PRIME

Weekly Commentary

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New week, same story: Ongoing concerns about euro debt and the U.S. economy kept upward pressure on short credit rates while the flight-to-safety trade continued full bore, pushing Treasury yields down to record lows. One-month and three-month London interbank offered rates (Libor) rose a basis point each last week to 0.24% and 0.36%, respectively, while six-month and one-year Libor rose 2 basis points to a respective 0.54% and 0.85%. Three-month, six-month and one-year Libor all hit new 52-week highs. On the government end, four-week and 13-week T-bills held at 0.00% and 0.01%, respectively, while 26-week T-bills slipped 2 basis points to 0.03%.

The big issue in the credit markets is the mess that is the European Union. Policymakers there can't seem to agree exactly what to do about Greece and other troubled debt-laden peripheral countries, and the lack of certainty is weighing on the capital markets given holdings of this sovereign debt by big German and French banks. Again, we'd like to emphasize that since the extent of the sovereign-debt crisis was first uncovered in 2010, Federated's conservative stance on managing and monitoring every security within its money market portfolios has resulted in extensive and continuous review of our portfolios' exposures to European senior bank debt. This has led management to shorten maturities, downgrade certain names and to eliminate others from its list of investable securities—and, because all of these securities roll over at short intervals, to quickly address its portfolios' exposures to any security.

In the United States, Fed policymakers did pretty much what we had expected (and hoped), initiating what is known as "Operation Twist''—the purchase up to $400 billion of longer-term Treasury securities (6- to 30-year maturities) through next June from the proceeds of the sale of shorter-term maturities (maturities of three years or less). The move was a little more aggressive than some had anticipated, with the Fed actively selling shorter-term securities to buy longer-term securities, instead of just purchasing longer-term securities with proceeds as existing securities matured. On the money market front, what was particularly noteworthy is what the policy-setting Federal Open Market Committee (FOMC) didn't do—lower or outright eliminate the interest rate on bank reserves. This brought a sigh of relief to the money markets, which feared the potential downward impact on yields as more short-term money potentially flooded into the money markets. As it is, the extension in the maturity profile of the Fed's balance sheet should serve as a yield flattener by helping bring down longer yields while introducing an upward bias on shorter rates.

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Indeed, almost immediately after the Fed announced its plan, prices on the intermediate 2-year to 5-year segment of the Treasury yield curve fell, pushing yields up, while prices rose significantly further out the yield curve, with the 30-year Treasury yield plummeting 19 basis points.

On the economic front, the week's news was slightly better than expected. August existing home sales rebounded 8%, the most this year, led by single-family homes and first-time buyers, and year-over-year sales are up 19%, pushing the inventory for sale to a 6-month low. Moreover, August building permits—one of 10 subcomponents of the leading indicators index—unexpectedly rose, helping the Conference Board's overall leading indicators for August rise 0.03% vs. a consensus forecast for no gain. Jobless claims also slipped on the week, though the 4-week average remained above 400,000, signaling a continuation of the sluggish job growth pattern.

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