Northern Trust | Peter Yi: Money Market Reform: Adjusting to the New Landscape

It's hard to believe that it's been over two years since the SEC announced its latest round of changes for the money market industry. Since then, the industry has spent significant time addressing these new changes and has seen investors, and markets, adjust to the new landscape.

What are the investor movements? As we've moved past the compliance state, we can now appreciate the magnitude of the investor movements that the industry has endured as a result of money market reform. Year to date, we've seen prime credit money market funds lose about 68% of its assets, while tax exempt money market funds have been reduced by 50% of its assets.

Meanwhile, government money market funds have been the clear beneficiary, increasing its assets by 73% across the industry-- this translates into about $900 billion in assets that have shifted into government money market mutual funds. With that kind of relatively quick movement year to date, it's only natural to expect the markets to adjust accordingly.

With enormous assets in motion, the supply and demand equilibrium has moved off kilter in the money markets. Credit spreads have widened meaningfully and government yields remain under heavy demand. LIBOR is one indicator of bank funding levels and has seen a dramatic increase over the last few months, and is now at a seven-year high. Tax exempt instruments have also experienced meaningful increases in rates since the beginning of the year. SIFMA, the weekly index of seven-day, high-grade, tax-exempt, variable rate investments commonly referenced for very short maturity municipal securities, has climbed from ascending at 1 basis point at the beginning of the year to almost 83 basis points today. Meanwhile, government yields continue to be anchored near zero.

What does this mean for investors? We believe the recent spread widening has mostly been technical and not of fundamental repricing in money market instruments. As investors, this creates tremendous opportunity in the marketplace. We believe this credit widening will be temporary. Over time, issuers will adopt new funding strategies and will likely move away from the money market sector, and start issuing in longer tenors outside of one year maturities given the very low, global interest rate environment.

As a result, today there's value in credit and tax exempt money market products, and the industry continues to offer vehicles that can capture this opportunity outside of government money market funds.