Money Markets: From Crisis to Opportunity in the Never Normal

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The global pandemic has brought unprecedented stress in business and markets. Much like various stages of grief, the effects of the coronavirus could be characterized in three phases – shock and awe, learning to cope, and optimizing for opportunity. These three phases tell the story of how investor behavior and the role of technology have played out in a snapshot in time during the crisis, and what it means for treasury moving forward.

To frame where we are today and gauge where we might be headed, it is helpful to take a step back to understand what treasury organizations experienced, beginning in March this year. The initial shock and awe of the pandemic saw treasury organizations de-risking their investment portfolios. They drew down credit lines, issued debt and shifted assets, moving aggressively into money market funds to ensure same day liquidity.

Using data from ICD, an independent portal provider of money market funds and other short-term investments, the picture of what happened in treasury from March through August 2020 is clear. During this stretch, the average daily balance in assets traded on ICD Portal increased 89% over the same period in 2019.

In Figure 1 we see a significant move out of prime funds in early March and into short term government money market funds. As treasury teams learned to cope with the new work-from-home environment and the continual realignment of forecasts to business operations, we see cash levels remain elevated. Uncertainty continued to fuel the need for liquidity, but treasury organizations sitting on large cash balances also began to look for opportunity.

Facing an extended period of potentially zero rates in government investment products, investors looked for opportunities that offered excellent liquidity but also more yield than found in traditional government money market funds. Investors came back into the prime space – and not just back to pre-COVID levels, but above pre-COVID levels. A notable 27% of respondents to *Treasury and Risk*'s 2020 cash survey also indicated prime funds were part of their portfolio composition.

Adding Value with Portal Technology

ICD's data against the industry benchmark shows that sophisticated investors acted more quickly than the rest of the market to de-risk portfolios in the early phase, and later identified opportunities in the money markets. This agility to move easily in and out of funds, and at the right time, is in no small part aided by technology.

Statistically and anecdotally, technology is proving its value during this crisis. The ability to gain transparency into holdings, model what-if scenarios, and use compliance and reporting tools to better communicate with the C-suite is empowering for treasury teams that need to make and defend informed investment decisions, quickly.

With 46% of respondents to *Treasury and Risk*'s 2020 cash survey reporting use of a non-bank investment portal exclusively, or alongside a bank portal, visibility and access to the markets seem to be key. ICD enables unbiased access to a wide selection of investment products all along the short-term investment curve, primarily in the money markets, but also extending further out in the ultra-short space, and even into traditional fixed-income bond funds. With over 400 active clients across 65 industries in 43 countries, an average daily balance of approximately $210 billion is running through the platform. As ICD is an independent provider whose sole focus is on treasury, activity on ICD Portal serves as a proxy for treasury's investment behavior.

Identifying Tradeoffs & Opportunities

During the March through August time frame, the opportunity was prime, but different opportunities emerge at different times. So how can treasury teams rely less on intuition and more on data? Earlier this year, ICD created a new quantitative model with The Carfang Group called Beta(m)™. Based on Modern Portfolio Theory (MPT) and adapted to the money markets, Beta(m) provides a quantitative approach to assessing tradeoffs and identifying opportunities among money market instruments.

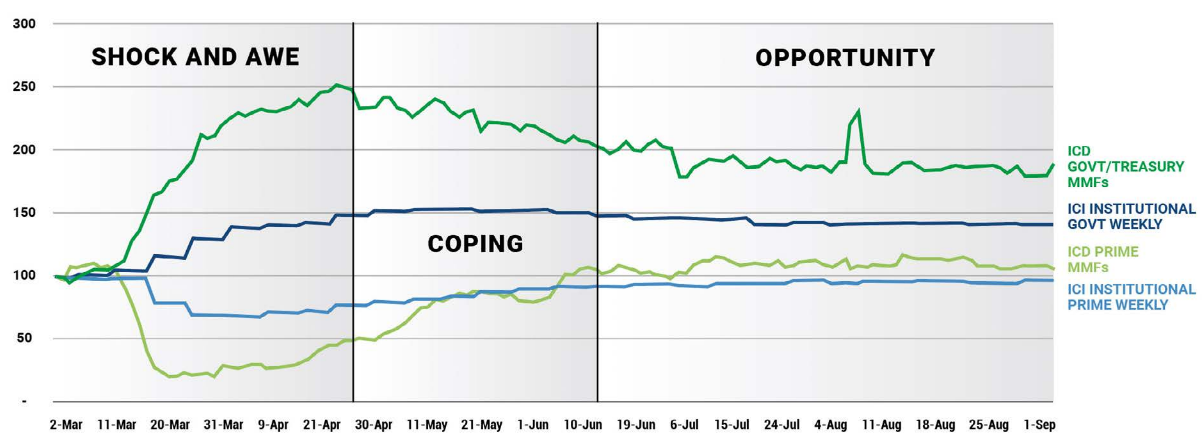
Beta(m) can help treasury teams understand the complex relationships among money instruments to determine opportunities. With Beta(m), teams can perform dynamic asset allocation among approved instruments and effectively communicate decisions or propose policy changes to executive management.

Going Forward in Money Markets

Unlike the global financial crisis of 2008, which was a credit event, the initial market fall out from the pandemic was a crisis in confidence. Monetary actions by central banks – from quantitative easing to the Money Market Mutual Fund Liquidity Facility in the U.S. – were put in place to ensure market liquidity, not to prop up failing or fundamentally flawed products.

Given the historical performance of money market funds over these past two market shocks, institutional investors seeking liquidity and security can keep yield in mind as well. In a balanced portfolio, these fund types are not mutually exclusive. While we've seen fluctuations from product to product, the adage of a risk-weighted, balanced portfolio is still the tried and true method for managing short-term cash – teams only need the right technology, tools and insights to do so.

ADB by Category - ICD Portal v. ICI Institutional



Source: ICD Portal and ICI Weekly Assets