# ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

July 8, 2011

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## Where Has the Yield Gone?

There are two separate, but equally troubling, issues for money fund investors these days. The first is absolutely rock-bottom yields, while the second is the continuing financial instability in Greece, which may be worming its way into several prominent European banks whose issues are often found in domestic money market portfolios.

How bad is it and what should investors do about it? The first part of the answer is, "Don't panic"--these are known issues that Fidelity and Vanguard (and any other money fund provider worth its salt) have taken steps to address. The two firms have taken different approaches to concerns over the Eurozone situation, but both have employed the same strategy to deal with ultra-low yields.

## Plunging Yields

The worst case scenario for a money market fund is to "break the buck," that is, for the fund's net asset value per share to drop below the stable $1 price its manager seeks to maintain. That does not appear to be in danger of happening at either Fidelity or Vanguard (the last time we saw a prominent money fund break the buck was during the financial crisis in 2008, when the Reserve Primary fund priced at under a dollar per share--this resulted in lawsuits and the fund eventually being liquidated).

What we have seen Fidelity and Vanguard's money funds experience are declining yields, which in most cases are now hovering just above zero, at 0.01% or one basis point. As of July 7th, only one investor share class money market fund in each firm's stable had a yield higher than 0.01%, Fidelity's Select Money Market, at 0.03%, and Vanguard's Prime Money Market, at 0.04%.

Both firms have taken the last-ditch step of issuing fee waivers in an attempt to prop up yields and avoid hitting zero. Vanguard has been waiving fees on its taxable money market funds for some time now and began doing the same on its tax-free funds in June. Fidelity held out as long as it could, but finally began waiving fees on its largest money market fund, Cash Reserves, some point at the end of June or in early July (other Fidelity taxable money markets have had fee waivers in place for a while).

While it's disconcerting to see yields dropping so low as to necessitate fee waivers--the income generated from a money fund's yield is the only means of earning a return on the investment--in another way, it's also comforting to know that Fidelity and Vanguard are willing to take the steps necessary to keep their funds in the black, if only by a razor-thin margin.

For investors who are looking to increase their yield without taking on too much capital risk, one measure we've suggested to certain investors for years now is to look at a short-term bond fund in lieu of all or part of a cash position. Fidelity's best short-term option is Short-Term Bond, while Vanguard has a couple of strong options available in Short-Term Investment-Grade, Short-Term Tax-Exempt and Limited-Term Tax-Exempt.

**Eurozone Worries**

As mentioned above, the other main concern for money fund investors is the Greek debt crisis, which could impact U.S. "prime" money market funds which invest in European banks that hold Greek debt. While we can’t speak to the safety of the majority of money funds, two of the largest in the country, Fidelity’s Cash Reserves and Vanguard's Prime Money Market funds, have limited-to-zero exposure.

Fidelity's Cash Reserves fund held about 11% of assets in three large French banks with exposure to Greek debt (BNP Paribas, Credit Agricole and Societe Generale) at the end of May. The reason for mentioning these three banks is that Moody's Investor Service, which rates the quality of bond issuers, said it was considering downgrading them due to that exposure. Fidelity remains confident in their investments in these banks, however, saying that a recent, feet-on-the-ground review of them and their holdings by a team of specialists (including the fund's manager, Robert Litterst) came up clean. We also see no reason to be concerned, and rate Cash Reserves as Fidelity's best taxable money market option.

Vanguard, which takes an extremely conservative approach to its money fund investments, has taken the "safety first" tack in regards to Greek debt--avoiding it as much as possible. Prime Money Market had 21% of assets in Euro-bank commercial paper and CDs through the end of May, but none of it was in any of the five PIIGS nations

(Portugal, Ireland, Italy, Greece and Spain), nor in French or German banks, big holders of Greek bonds. Instead, that 21% is spread among banks in Norway, the U.K. and other countries that do not use the euro.

While super-low yields and the Greek debt situation may be troubling, we believe that Fidelity and Vanguard's money market funds remain safe investments. You may be missing out on income by sticking with them, but it appears highly unlikely that you'll lose any capital.

**About Adviser Investments**
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