

Money Fund Intelligence



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Quiet Giant of Cash: Q&A w/Northern Trust

This month we interview members of **Northern Trust's Money Market Fund** team, including **Steve Everett**, Director of Balance Sheet, Assets, and Insurance, **Peter Yi**, Director of Money Markets, and Investment Strategist **David Rothon**. Northern manages over \$70 billion in money funds, and the company ranks even higher among cash and short-duration managers when bank trust and securities lending pools are counted in the totals.

Q: How long has Northern been running money funds? How important are they?

Everett says, "Northern has been running money funds since the beginning of the 1980's. It is a material business for us.... We clearly manage more cash investment products than our money market funds, and that product suite is a meaningful business unto itself. We were also the 4th fund manager to launch offshore funds in Dublin back in the mid 1990's, so we were an early player across the Pond."

Q: What's the biggest challenge in running a money fund?

Yi says, "**The biggest challenge for a money fund is really finding that balance between principal preservation, liquidity management, and offering a competitive yield.** We believe you should also have a conservative, consistent, and unwavering investment philosophy and investment process that will function well in any environment. Another challenge is having the right infrastructure to support your money funds. That's going to include having economists, research analysts, compliance officers, traders, trading support and of course experienced portfolio managers."

Q: Has requesting information become a two-way street?

Everett responds, "Whenever we have had someone that was coming into our products of size, we always seek

to understand their investment needs with reasonable precision including their timeline for investment. We seek to ensure all investors receive consistent treatment, so we do not permit overly large investors that could adversely impact the underlying product performance. If a client needed accommodation and they were going to be some more material portion of a vehicle, that's then where they might be less free to move or their needs may be met across multiple products."

Q: How important are the asset flows to managing the funds?

Yi tells us, "It's incredibly important, and understanding a fund's asset flows is a crucial element to money fund management. As we observed with the Reserve Primary Fund last year, it's not just a credit event that can lead to a fund 'breaking-the-buck.' It was really the redemptions

that followed that credit event that precipitated the fund collapse after the paired

"We believe you should also have a conservative, consistent, and unwavering investment philosophy and investment process that will function well in any environment."-Northern's Peter Yi

credit represented a larger percentage of a now smaller fund. So, it's important to really get as much guidance as you can from your clients, as well as to have enough liquidity to accommodate any redemptions that may come your way."

Q: What's been the key to Northern's success in the money markets?

Yi says, "One has been our investment philosophy. Two has been the benefit of a strong bank parent with a cash management business that is core to its overall corporate strategy. And third has been offering a solutions-based approach to cash management. We've always managed our money funds conservatively. We've

always put principal preservation above all else, followed by liquidity, then finally yield. We believe this conservative positioning really defines us as investment managers."

"With the new money market proposals likely to be passed and implemented in some form, I think it's realistic to believe that our approach will now become standard.



Steve Everett

We don't expect these new proposals to affect our day-to-day management of our money market funds. Where we see real benefit is in continuing to be a leader in a stronger and more stable industry. Given our more stringent practices and investment process that emphasizes credit research and risk management, we will be positioned well when these proposals are adopted," he tells us.

Everett adds, "Our investment philosophy is not a reaction to what has happened in the markets. That is the way we've always been.... and we don't waver from that approach. **Our consistent philosophy and approach has been an important ingredient in how the firm has become successful over time.**

Maybe a few years ago, people may have thought we were too risk averse and an underperformer, and now they think we're brilliant.... We're really neither. It's more our strategy and our philosophy that we stick to and believe is appropriate in delivering competitive returns in a risk controlled environment for our clients."

Q: What are and aren't you buying now?

Yi tells us, "We continue to focus our longer-term purchases in U.S. government, U.S. agency and FDIC-backed debt even for our prime funds. Our allocations to these sectors have increased over time and we remain overweight."

(Northern cont. from p. 1)

Given our expectations for a lower interest rate environment for an extended period of time, we are comfortable opportunistically using those security types to add duration and ultimately get longer to our peer groups. Given the flatness of the yield curve, we're also seeing opportunities in products like agency callable securities that offer a little more yield without compromising credit risk."



Peter Yi

He adds, "We are also active purchasers in shorter maturities in certain banking institutions that we believe are well capitalized and well positioning in this challenging operating environment. We continue to purchase shorter maturities in asset-backed commercial paper programs of the highest quality that benefit from strong bank liquidity support agreements. We are not purchasing various security types that we believe lack a sufficient secondary market."

Q: What do you think investors should be looking for in a money fund?

Yi says, "I think investors are going to want a very conservative investment philosophy with a very strong investment process. They're going to want a money fund complex that has plentiful resources. They're going to want strong bank parents going forward. And they're going to want transparency and greater disclosures with regard to holdings and fund characteristics."

Everett responds, "**I would say they want an investment process that's not just conservative but one that is consistently applied.** Some funds give the portfolio manager decisions on credit; we don't. I think the whole bar has been raised in the industry. Some participants

in the market are [now] interviewing the people that are managing the money and [examining] how they make decisions. So I think that's a big change too. People are actually taking the time to learn about your investment process and the decisions you make."

Q: How are MMFs faring in Europe?

The London-based Rotheron responds, "Some investors will still only invest in government liquidity funds.... **Although the markets have improved, risk aversion is still clearly elevated amongst the corporate community....** It's going to be absolutely crucial going forward to maintain product integrity and enable people to asset allocate within cash. What you don't want to do is dial up risk within your money fund ... to satisfy a higher-risk profile need. If they want more risk, you move them out of government into the traditional. If they want more risk than traditional, then you move them out to a variable NAV fund."

Q: Tell us about offshore customers.

Rotheron says, "We have a multitude of clients, because of the nature of Northern Trust's businesses. A lot of custody clients use the fund as a sweep option. So we have a mix of private wealth, central bank, sovereign wealth money, local authority or public sector money, corporate pension funds, corporate money, as well as direct investors.... So we can get a good mix and a good feel for what people are looking for. In the offshore space, we're certainly ramping up our distribution efforts with additional resources in portfolio management and sales. We see this as a very core activity for Northern Trust as a bank and asset manager with over \$200 billion in cash and short duration."

Q: Do you run securities lending pools?

Everett says, "**The custody business and the securities lending business have always been large cash invest-**

ment businesses for Northern. That gives us a scale to compete that's beyond what you see on the surface in our money fund complexes." Yi adds, "The bulk of our securities lending funds are being managed just as conservatively with a very similar strategy to our 2a-7 funds."

Q: Are zero yields a threat?

Yi says, "The incredibly low interest rate environment in absolute terms is a huge challenge to the money fund industry, especially when you consider all the other asset classes that have been doing so well over the past 3 or 4 months.... **But at the same time, liquidity is something that has been valued in every market cycle.** Where I do think there is uncertainty is with the new money fund proposals and with the eventual exit strategy for the Federal Reserve and other central banks to remove their unprecedented accommodative policies. What impact is that going to have on the money fund industry? It's that corrosive effect of uncertainty that can really hurt an industry or a sector. Those are going to be the bigger risks out there."

Everett says, "The bottom line is that as long as interest rates get up off the floor sooner rather than later, the industry will live to fight another day. Ultimately, if you look at the low interest rates alone, that clearly cramps your revenue and your profit. So that then gets to how much staying power do you have? How core is this business to you? If it lasts longer, more competitors may fall by the wayside.... For Northern, where it's a core business with multiple product and distribution structures, it allows us to continue to add scale and market share over time."

Finally, he adds, "We only need a rate hike or two and the industry can breathe a little bit easier." ♦

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