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Sung Nam

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Breaking the Buck

Money market funds have provided short term investment opportunities for institutions and private investors which have preserved capital while providing slim returns. Breaking the buck, or when the NAV of the MMF falls below $1, occurs when the returns generated from the funds doesn't cover the operating expenses of the fund, or investment losses. MMFs provide higher yields than savings accounts by investing in short term Treasuries and commercial paper. The weighted average maturity (WAM) is less than 60 days and invests in highest rated debt maturing under 13 months.

Recently, when Lehman filed for bankruptcy, the oldest MMF booked the write off of their investment in Lehman debt, dropping NAV to 97 cents. This caused a run on the MMF, causing massive redemption and subsequent fire sale of the assets held by the MMF. The government intervened and provided a backstop through a FDIC like insurance for investors who invested prior to Sept 2008.

The situation could have developed into a run on the shadow banking as investors lost confidence in companies' ability to finance the commercial paper, which was purchased by MMFs. So, companies wouldn't be able to roll their debt, making companies insolvent and leading to bankruptcies, eventually halting the system.

The historic spread between bank savings account and MMF was stable and beneficial for investors. However, with the low rates offered on Commercial paper and short term maturity Treasuries, MMFs are realizing negative yields in some instances, making many investors wonder of the advantage of investing in MMFs, instead of simply parking the cash in a bank deposit.

It is a rare case to break the buck, as institutions who manage MMFs will foot the losses to raise the NAV to $1.00. Also, the government intervention will mitigate risk. However, we question the current market environment to justify MMF investment, with yields so slim, and spreads not considerable.