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A WORD ON MONEY-MARKET FUNDS

# HIGHER INTEREST RATES HAVE MADE MONEY-MARKET FUNDS MORE ATTRACTIVE

**With initial key rate cuts expected for 2024, Daniel Bernardo, Co-head of money-market strategies at Ofi Invest Asset Management, provides us some insight into this asset class, which was pushed back into the spotlight by last year's rate hikes.**

## How is the money market faring and what is its outlook for 2024?

With €ster still close to 3.90% in March, the money market offers a yield that we feel is attractive while incurring little risk. This should last at least until the initial ECB rate cut. Based on current expectations, money-market funds' could yield even more in 2024 than in 2023 (3.28% for €ster capitalised). Global inflation continues to recede, as expected by central banks, but core inflation is only grudgingly moving back to their targets. Central banks have emphasised this and will wait patiently before lowering their key rates this year. Market expectations are now aligned with our own expectations we had at the start of the year, i.e., two or three rate cuts this year, with the first one coming by this summer. We see no urgent need for a rapid and aggressive easing in monetary policy. Inflation in services is holding steady, as is economic activity. We expect an easing of about 75 basis points in the euro zone, beginning in June. And we expect monetary policy on the whole to remain restrictive in 2024. Caution remains the byword, given some stubborn uncertainties. The factors that could affect and drive inflation are so numerous and so varied that central bankers will have to show lots of patience to make sure that the recent months' downward trajectory in inflation is sustainable.

## How do your largest funds find enough paper to invest in?

Money-market funds obviously must deal with the market breakdown as it is. About 75% of money-market issuance in France is in the banking sector, according to data from the Bank of France. This is why financial issuers are overweighted in the funds' assets. As for non-financial issuers, we have seen a shift in recent years. Issuers are smaller, as can be seen in the size of their issues. Some issues can be as small as 200 or 300 million euros, which are often too small to interest large funds, despite the potential additional yield they offer to offset their lower liquidity.

We have also noticed that while banking spreads have held steady, the hierarchy of spreads among non-financial issuers has shifted. Some companies have lots of cash. As a result, their spreads are close to those of banking issuers and therefore look very expensive. Diversification into non-financial issues has become more challenging but can be done geographically. For example, managers will try to invest in debt of Spanish, Italian or Nordic banks.

## During Covid, companies exited money-market funds to cover their liquidity needs. Is management of the liability side of money-market funds as important as the asset side?

As money-market fund managers, we must be diligent regarding the composition of liabilities and how they are diversified, so that market shifts do not trigger heavy, simultaneous redemptions. Since 2019, money-market funds have had to meet a daily liquidity ratio equal to 7.5% of their net depositary assets, on top of a 15% weekly liquidity ratio. We can also invest the equivalent of 10% of net assets in money-market funds (no more than 5% per fund). Accordingly, money-market funds have at all times between 8% and 20% of their assets available to them. In addition, careful watch must be kept on maturities and credit quality in order to safeguard both the fund's liquidity and its security. We also have a significant store of securities issued by French banks. On top of the liquidity that they provide, they allow us to steer our performance by positioning ourselves on long maturities that offer higher yields.

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## What are the advantages of a money-market fund vs. a term deposit?

There are some important differences between term deposits and money-market funds. Money-market funds are highly diversified. The largest of them can be invested in more than 100 holdings, with maturities that are also highly varied. All this reduces the risk considerably compared to a term deposit, which is exposed to single-counterparty risk. A money-market manager is also nimbler and can adjust to market events. To cite one example, in 2022, we thought that inflation was actually sustained, not transitory, and we therefore set up macro hedge swaps, which allowed us to move interest-rate sensitivity by 1 to 3 days. Thanks to this hedge, we were able to tap into successive rate hikes. We also adjusted our funds' credit sensitivity(1). Such responsiveness by money-market funds is also why the asset class continued to attract inflows even when interest rates were negative for several years.
In managing a money-market fund, it is also possible to exploit the shape of the curve. Take the €ster curve, for example. Its pivot is currently at three months. For maturities of one and two months, the yield is 3.9% but for three months, it's 3.87%. Money-market managers can exploit these 3 basis points and vary their investments in order to boost their returns. The same thing can be done on each point of the curve, in order to exploit any shifts in the yield curve, which are currently reflecting expectations of an easing in the ECB's monetary policy. Money-market funds, which offer no capital guarantee, have the advantage of being more liquid than other asset classes, with a level of risk of 1 on the SRI scale (which ranges from 1 to 7).

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## Your money-market funds integrate ESG criteria. Will their managers have to adapt to the new French *ISR* [SRI] Label?

Ofi Invest Asset Management's money-market range is indeed certified under the *ISR* [SRI] label. We are paying close attention to the shift in the French *ISR* [SRI] label from version V2 to V3, as the levels of exclusions will increase. Among other things, "best-in-class" funds will have to exclude 20% to 30% of the investment universe. We will have to take on board the consequences of this change, whether in assessing our funds' liabilities or in analysing the potential performance impacts of this new version of the label.

## Are money-market fund clients becoming more diversified?

Money-market funds are currently trading on a high-volume market dominated by large institutional investors and major corporate issuers. Nevertheless, we are now seeing renewed and growing appetite from retail investors and wealth management advisors. The yields on offer are attractive enough to draw in these new clients.

*[1] Sensitivity is a measure of interest-rate risk tied to a bond based on its maturity, yield, coupon and early repayment terms.*



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