

Maryland Local Government Investment Pool 1st Quarter 2012 Review

At the start of the first quarter of 2012, the overall tone was one of improvement. Are we beginning to see a flicker of light at the end of the tunnel? According to the Federal Open Market Committee (FOMC), the economy expanded moderately and strains in global financial markets have eased. Household spending has strengthened. Conditions in the labor market continue to improve, however, the unemployment rate remains above levels consistent with a sustained jobs recovery. Maybe we shouldn't get ahead of ourselves, though. Towards the middle of the quarter, we began to see signs of that old familiar uncertainty. By the end of March, renewed discussions which focused on additional quantitative easing were becoming more prevalent.

The FOMC voted to maintain the target range for the federal funds rate of 0 to 25 basis points (bps) at both meetings during the first quarter. The committee altered their stance slightly, and at the January meeting, stated that, "economic conditions... are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014." This new statement represented an extension from their previous anticipation of exceptionally low levels through mid-2013. In addition, the committee held fast in their commitment to employ additional tools, if necessary, to promote a stronger recovery. While the current "Operation Twist" does not end for another three months, Chairman Bernanke's comments towards the end of the quarter from a speech given at the National Association for Business Economics Conference, coupled with the minutes from the March 13th FOMC meeting, indicate that the door has been left ajar for an additional round of quantitative easing. There may be fewer supporters now than there were in January, however, the possibility is not off the table just yet.

During the quarter, the LIBOR curve flattened by about 8 bps. Overnight LIBOR remained anchored around 15 bps while 1-year LIBOR declined from 1.13% to 1.05%. Three-month LIBOR experienced the largest change, decreasing by about 11 bps during the three months. Much of the decline in LIBOR can be attributed to improved conditions in the Euro zone. The introduction of the three-year Long-Term Refinancing Operations (LTRO) by the European Central Bank (ECB) in December, and a second LTRO at the end of February, helped alleviate some of the pressure by providing additional liquidity to member banks in exchange for collateral. This European version of the quantitative easing implemented in the United States made cash available to banks previously unable to obtain funding. As a result of the improved environment, money funds started stepping back into European bank names. According to JP Morgan, prime funds increased Euro zone bank exposure by almost \$60 billion during the first two months of the quarter, increasing in January for the first time since April of last year. Funds also returned to investing in previously shunned French bank paper, albeit cautiously.

Casting a shadow over the money market industry during the first quarter was the much anticipated money fund reforms expected to be proposed by the SEC. Potential changes include mandating a floating net asset value (NAV) for money funds which currently operate with a stable \$1 NAV, and requiring a capital buffer and a holdback of redemptions to protect against a run on funds. During the quarter, there was an abundance of opposition to the suggested changes, and although the proposals were originally expected before the end of March, we are going to have to wait a little longer. Also, in mid-February, Moody's announced that it placed the ratings of several global capital market intermediaries and several large foreign banks on review for downgrade. Many of these entities are large players in the short-term markets and downgrades could further restrict allowable investments for money market funds. The reviews will likely take place in the second quarter so again, we are forced to wait a little longer to see the effects.

Although the Maryland Local Government Investment Pool (MLGIP) continued to feel the effects of very low yields in the short end of the curve, yields on agency discount notes and United States treasury securities improved during the quarter easing some of the pressure felt during the previous few quarters. We continued to maintain the maximum allocation to commercial paper allowable in the MLGIP in order to maximize yield. We also actively added Agency floating rate notes when appropriate, as floating rate notes were once again an attractive alternative to comparable maturity discount securities. The MLGIP ended the quarter with an average weighted days-to-maturity of 52 days. We will continue to monitor the economic conditions, the changing landscape of the money markets, and FOMC comments closely, striving to appropriately position the MLGIP to earn a competitive yield while minimizing risk.

PNC Capital Advisors, LLC ("PNC Capital"), a registered investment adviser with the SEC, is a subsidiary of The PNC Financial Services Group, Inc. ("PNC"). PNC Capital serves as sub-adviser to the Maryland Local Government Investment Pool. PNC is one of the nation's largest diversified financial services organizations. PNC provides investment and wealth management, fiduciary services, FDIC-insured banking products and services and lending and borrowing of funds through its subsidiaries. Neither PNC nor PNC Capital provide legal, tax or accounting advice.

PNC Capital provides investment management services. This report is furnished for the use of PNC Capital and its clients and does not constitute the provision of investment advice to any person. It is not prepared with respect to the specific investment objectives, financial situation or particular needs of any specific account. Use of this report is dependent upon the judgment and analysis applied by duly authorized investment personnel who consider a client's individual account circumstances. Persons reading this report should consult with their PNC Capital account representative regarding the appropriateness of investing in any securities or adopting any investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. The information contained in this report was obtained from sources deemed reliable. Such information is not guaranteed as to its accuracy, timeliness or completeness by PNC Capital. The information contained in this report and the opinions expressed herein are subject to change without notice. Past performance is no guarantee of future results. Neither the information in this report nor any opinion expressed herein constitutes an offer to buy or sell, nor a recommendation to buy or sell, any security or financial instrument. Accounts managed by PNC Capital and its affiliates may take positions from time to time in securities recommended and followed by PNC affiliates. **Securities are not bank deposits, nor are they backed or guaranteed by PNC or any of its affiliates, and are not issued by, insured by, guaranteed by, or obligations of the FDIC, the Federal Reserve Board, or any government agency. Securities involve investment risks, including possible loss of principal.**

©2012 The PNC Financial Services Group, Inc. All rights reserved.