Dissecting the dots

BlackRock.

US Cash Management investment commentary

Q2 2024

Market outlook

- Information contained in the Federal Open Market Committee's (FOMC, the Committee, or the Fed) Summary of Economic Projections (SEP) released at the June meeting reflected a projection for a smaller removal of policy restraint this year relative to the forecast in March amid expectations for slightly higher core inflation and unchanged economic growth and employment.
- Against this backdrop, we believe it's possible that the FOMC could eventually move to adjust the federal funds target range modestly lower later this year should data point to an easing in price pressures or a significant softening in the labor market, while also acknowledging greater uncertainty about the outlook for rates given recent sticky inflation and resilient employment data.
- Net T-bill issuance is expected to pick up in July following a contraction in the second quarter, and the additional supply should, in our view, generally continue to be well absorbed.

Q2 highlights

- The FOMC maintained the range for the federal funds target rate at 5.25% to 5.50% during the second quarter as it continued in our view to cautiously assess the effects of its policy firming to date.
- In a statement[1] released in conjunction with the June meeting, the Committee noted that inflation has "eased over the past year" while acknowledging it "remains elevated" and noting recent "modest further progress toward the Committee's 2% inflation objective."
- Further, the statement in June acknowledged that the FOMC "does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward" its 2% target.
- The median federal funds rate forecast contained in the Summary of Economic Projections (SEP)[2] released in conjunction with the June FOMC meeting for 2024 rose to 5.10% from the March 2024 projection of 4.60%, implying in our estimation one cut of 0.25%, down from the prior projection of three cuts of 0.25%.
- The updated SEP for 2024 reflected a modestly higher core inflation projection and unchanged economic growth and unemployment rate forecasts, relative to the March projections. Core inflation is still not projected to fall to the FOMC's 2% objective until 2026.
- Net T-bill issuance dropped approximately $296.5 billion during the quarter.[3] While average daily RRP utilization moderated relative to the prior quarter, daily usage rose to $664.6 billion on the last trading day of June, from $594.4 billion on the last trading day of March.[4]
- Assets across the US money market fund (MMF) industry increased $61.32 billion during the second quarter. Assets in municipal MMFs, prime MMFs and government MMFs rose by $7.82 billion, $19.28 billion and $34.23 billion, respectively.[5]

The Fed's "dot plot" interest rate forecast implies one cut in the federal funds target range during 2024. We believe the FOMC could move to adjust the federal funds rate modestly lower should data evidence an easing of inflation or a significant deterioration in labor market conditions.

Our assessment of the timing and magnitude of any future downward adjustments in the Fed's key policy rate will continue to affect our investment strategy.

Net T-bill supply is expected to be positive in the third quarter of 2024 in contrast to the drop in the prior period. This supply should generally continue to be well absorbed in our view.

Sources 1, 2: US Federal Reserve as of 12 June 2024. 3: US Treasury as of 27 June 2024. 4: Federal Reserve Bank of New York as of 28 June 2024.
5: Investment Company Institute as of 28 June 2024. The BlackRock opinions expressed are as of 30 June 2024 and are subject to change at any time due to changes in market or economic conditions. Forecasts are based on estimates and assumptions. There is no guarantee that they will be achieved.

Money market fund strategy

Government & Treasury funds

Similar to the increase in government MMF assets across the industry, BlackRock government funds experienced net inflows during the second quarter.

Short-term Treasury rates were relatively stable throughout the quarter, as markets digested softening economic data. The 1-month Treasury bill ended the period down 2 basis points at 5.37%, while yield on the 12-month tenor closed the quarter up 8 basis points at 5.13%. The 6-month T-bill hit a high of 5.18% during the quarter and finished the period slightly lower at 5.11%.[6]

Industry wide, WAMs have decreased from recent highs as investors seek clarity on the future path of rates. Although the recent Summary of Economic Projections pointed to the median dot moving from three rate cuts in 2024 down to the one rate cut, the implied pricing in the futures market continues to respect the potential for two rate cuts in calendar year 2024. As such, we continue to selectively add longer, fixed-rate duration to lock-in term rates, as overall economic and inflation data has softened and created uncertainty regarding the future path of monetary policy.

At the start of the quarter, weighted average maturities (WAMs) in our government funds hovered near 45 days for repo-eligible funds and 49 days for non-repo funds. By the end of the quarter, these figures decreased to 39 and 45 days, respectively.

Purchases throughout the quarter were mostly comprised of 2-month and 3-month T-bills at an average yield of 5.39% and 6-to-12-month T-bills at an average yield of 5.35%[7]

Year to date, markets received nearly $880 billion of Treasury bill and coupon supply, with a heavy skew towards bills. Additional projected issuance is expected to be skewed towards coupons.

While eligible funds continued to utilize the Fed RRP throughout the period, aggregate usage of the facility steadily declined. Investors who favored the Fed RRP as an alternative to short-dated government securities began to rotate into new Treasury supply, and dealer repo rates remained more attractive, in our opinion.

Prime funds

Consistent with the increase in assets of prime MMFs across the industry, BlackRock prime funds experienced net inflows during the second quarter.

We believe investors exhibited demand for prime funds to take advantage of the incremental yield and diversification. At quarter-end, the spread between institutional government and prime MMF yields was 0.14%.[8]

Tier 1 Commercial Paper (CP) outstandings increased slightly by $0.5 billion over the quarter to $396.9 billion. As expected, CP rates continued to reprice in line with expectations for the future path of monetary policy. Financial CP within our prime funds maturing in three months or less ended the quarter with an average yield of 5.40%.

Rates on money market deposit instruments, including time deposits and certificates of deposits, remained relatively consistent throughout the quarter, as overnight rates averaged 5.32%, slightly below the quarter high of 5.35%.[9] Our prime funds favored these investments. Purchases during the period were primarily of certificate of deposits and time deposits, CP and overnight repo for eligible portfolios.

Although we favored a shorter-duration stance over the last several months to protect against interest rate risk, we have been more focused on adding exposures to highly rated longer tenor fixed positions to add duration where appropriate to lock in attractive fixed-rate positions ahead of the Fed's anticipated easing cycle. At quarter end, our target WAM range was 45 to 50 days, and the prime funds had an average weekly liquidity of approximately 64%.[10]

Sources **6:** US Treasury as of 28 June 2024. **7:** BlackRock Aladdin as of 28 June 2024. **8:** iMoneyNet as of 28 June 2024. **9:** Federal Reserve as of 28 June 2024. **10:** BlackRock Aladdin as of 28 June 2024. The BlackRock opinions expressed are as of 30 June 2024 and are subject to change at any time due to changes in market or economic conditions. Forecasts are based on estimates and assumptions. There is no guarantee that they will be achieved.

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Money market fund strategy

Municipal funds

In the second quarter, tax- exempt money funds saw net inflows, ending with approximately $129 billion in industry assets. Dealer variable rate demand note (VRDN) inventory ended the period at $1.5 billion, well below the rolling 12-month average of $4.2 billion. VRDN new issuance remained light as the municipal yield curve remained inverted out to 15 years. The Securities Industry and Financial Markets Association (SIFMA) Index, which represents the average yield on 7-day municipal floating-rate debt, began the quarter at 3.64%, fluctuated between 2.89% and 4.35%, and reset to 3.88% at quarter-end.

Within the fixed-rate space, 1-year municipal bond yields decreased from 3.24% to 3.15%, while 1-year municipal note yields increased over the quarter from 3.32% to 3.51% amongst increased municipal note supply.

YTD Municipal note issuance continues to tick higher as we've entered the seasonally-heavy summer months, however overall note issuance remains subdued compared to pre-pandemic levels as municipal fundamentals remain supportive.

MuniCash was positioned in the 5- to 6-day WAM range with high levels of daily and weekly liquidity, as the Fund intends to invest solely in securities that are considered weekly liquid assets under Rule 2a-7 under the Investment Company Act of 1940, as amended (the "1940 Act"), typically maturing in five business days or less.

Looking ahead, summer month technicals will continue to affect the availability of inventory as VRDN supply is typically lower and may entice dealers to move VRDN yields lower from the current levels, if demand for VRDNs persists.

Ultra-short bond fund

Consistent with the theme across the ultra-short bond industry, the BlackRock Short Obligations Fund experienced net outflows throughout the second quarter.

Tier 1 CP outstandings slightly increased by $500 million to $396.9 billion during the quarter. Tier 2 CP outstandings decreased by $12.7 billion to $102.1 billion at the end of June.[11]

Yields in the Investment Grade (IG) space were volatile throughout the quarter, with the yields on the JULI All Ex EM 1- to 3-year Index ranging between 5.23% and 5.62%.[12]

For the first two months of the quarter, IG spreads were tight as investors' demand for high quality duration securities outpaced supply. Spreads slightly widened in June due to quarter-end dynamics and front-end investor repositioning. IG yields ended the quarter lower as rates responded to changing Fed expectations.

After heavy IG issuance during the first quarter, supply for the second quarter slowed down, but remained strong: nearly $342 billion in supply came to market, largely driven by non-financials. Overall, investors continue to assess the Federal Reserve's path of monetary policy and the outlook for economic growth.

Throughout the quarter, our focus was keeping the fund well positioned by focusing purchases on CP maturing between 1-week and 6-months at yields ranging from 5.50% to 5.68%. Other investments consisted of bonds maturing in 2-years and beyond at a 5.16% yield and 6- to 12-month CDs with yields ranging from 5.52% to 5.75%.

We largely believe that the Fed has reached the endpoint of their aggressive hiking cycle and the next move in rates will be lower. We look to maintain a neutral to long duration bias to lock in income via longer rates and IG securities where valuations present themselves.

Sources 11: Federal Reserve as of 28 June 2024. 12: JP Morgan as of 30 June 2024. 13: BlackRock Aladdin as of 28 June 2024.
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Want to know more?

blackrock.com/cash | cashmgmt@blackrock.com | 800-441-7450

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Please consider the investment objectives, risks, charges and expenses of the BlackRock Short Obligations Fund carefully before investing. The Fund's prospectus and summary prospectus contains this and other information about the Fund and are available, along with information on other BlackRock Funds, by calling 800-441-7762 or by accessing the website at www.blackrock.com/cash. The prospectus should be read carefully before investing.

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