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# O.F.O. Partners



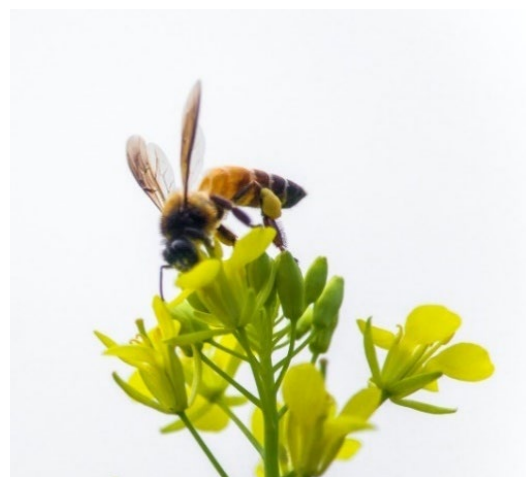
## Money and Honey Summer 2021

In the summertime, we share our world with all kinds of bugs. Some do important work without much notice. For example, the common honeybee supports the super-highway of our food supply. Bees pollinate most of the world's flowering plants, including \$20 billion of U.S. food crops.

In financial markets, your dollar bills make the system go. Your cash flies around (both physically and digitally) to create the base of the money chain.

This summer, both bees and bank deposits are going through a tough season. Money is too cheap, and honey is too dear. The result is a frenzy of empty flapping in cash markets that we will describe for you here.

In our opinion, the dry spell is not going to end any time soon. But you can still find income on your balances if you know where to look.



## How bad is it?

With interest rates low for so long, a lot of people have gotten used to crummy yields on their cash. At O.F.O., it's like a mosquito that keeps buzzing while one tries to sleep. It drives us crazy.

Let us tell you about a friend with \$1.4 million in cash at their financial institution. Before the Global Financial Crisis, this investor would have earned about 4.3 percent in yearly interest. This rate should provide **\$5,049 in monthly income**. That's enough to grab a pair of round-trip tickets to Hong Kong on British Airways today. You could rent a one-bedroom apartment on 11<sup>th</sup> Avenue in New York City, or book the week at an eight-bedroom house on Myrtle Beach. If you prefer gadgets to experiences, you could buy a brand-new [all-terrain vehicle](#) every month.

Instead, the \$1.4 million balance produced a minuscule **\$55.07 in interest** last month.

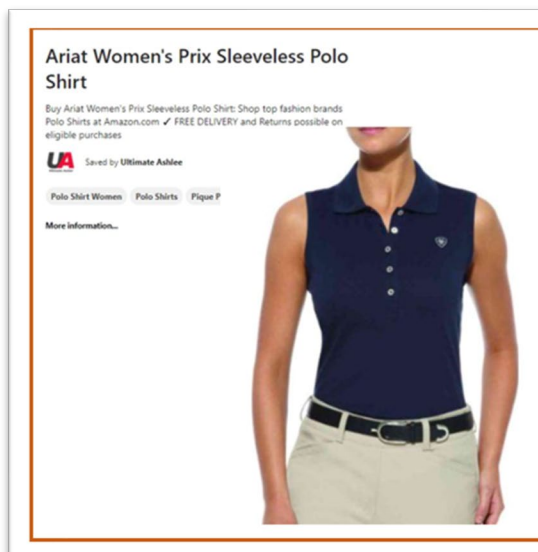
That's not a lot of nectar.

What kind of luxury travel or Manhattan apartment can you get for \$55.07 per month? Maybe you can afford ten pounds of [decent coffee](#), an off-brand sleeveless polo shirt, or the bulb for a Chevy Silverado headlight. Forget about staying over in the city. Figure 1 below shows how far we have fallen.

Figure 1. Has interest rate policy gone awry?

Comparing available purchases from the interest earned on \$1.4 million in the bank: 2021 versus 2005

2021 (\$55.07)



2005 (\$5,049)



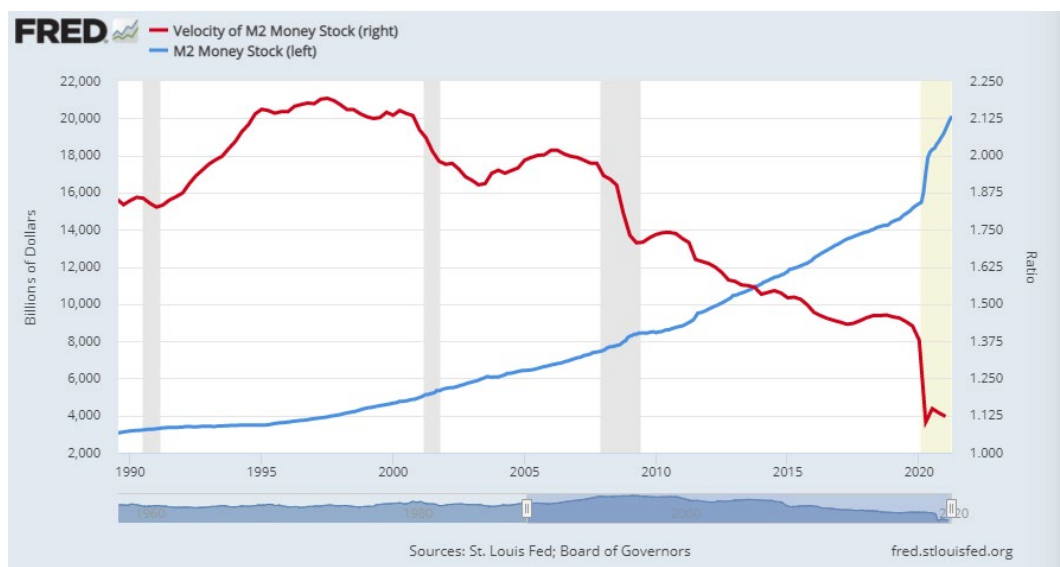
For individual clients, the foregone interest income is painful. But consider, for a moment, the \$20 trillion in cash floating around the U.S. financial system. That amount represents 89 percent of our GDP, a historical record. If overnight yields were merely two percentage points higher than they are today, then depositors would earn \$400 billion in additional income per year on their cash. Today's policies transfer mountains of wealth from savers to borrowers month after month.

### How long will it last?

How much longer can this trend continue? We may have an answer. The major financial pollinators – the U.S. Treasury, the Federal Reserve, and the banks – have begun to dance like honeybees as a direct result of the excess liquidity. Like bees, the waggle tells us how far to fly for nectar.

This dance begins with quantitative easing (QE) – the Fed's purchase of financial assets in the marketplace. QE pushes more waves of cash onto banks' balance sheets than the the institutions can lend out. The banks then shun new deposits, forcing the liquidity into money market funds. In turn, these funds, having gobbled up safe instruments like T-bills, push surplus cash back to the Federal Reserve using a facility called the "reverse repo program" (RRP). The RRP has become a hive (and final resting place) for all of this liquidity. The RRP has grown to nearly \$1 trillion in size. You can see in Figure 2 that increasing the aggregate money stock has not increased the mobility of cash around the economy. In fact, the reverse has occurred.

Figure 2. Velocity of M2 Money Stock, St. Louis Federal Reserve, 1990 – 2021.



Clearing the nest of the surplus cash will not be quick. For one thing, there is now the equivalent of eight months of QE activity sitting back at the Fed in the form of RRP. The Fed went to a lot of trouble to create that liquidity just to have it land back at their hive.



Some view the RPP as successful because interest rates have not fallen below zero percent on savings. The Fed recently widened the participant pool in further support of the program. In the meantime, savers like you will remain stuck in the gummy heat, earning less than the rate of inflation on your cash for quite sometime.

### How will we get out of it?

At O.F.O., we are here to help you to overcome the trap of zero income. Our approach begins with understanding that the path of interest rates is highly uncertain. We want your savings to be safe.

In conjunction with several large family investors, we have developed liquid portfolios for this purpose. You can derive reliable income while managing duration and credit risk. Bringing a cash strategy into the light of other investment activities ensures success, since cash is just a piece of your overall net worth.

What types of strategies fit the bill? For one thing, the Fed has committed to supporting the recovery. In our view, this decision leaves room for a sustained period of favorable credit conditions.

Certainly interest rates may rise as the economy improves. The Fed's honey dance includes signals about that, too. In the meantime, you can optimize your position with a few simple strategies that will allow you to participate as the economy expands.

Let us know if we can help you as you fly around this summer. In the meantime, best wishes from your friends at O.F.O. Partners.

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