



# Market Perspectives

CITY NATIONAL ASSET MANAGEMENT

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## Know What You Own

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Conservative investors who have emphasized cash and high quality bonds may be congratulating themselves for skirting much of the damage inflicted by the sovereign debt crisis engulfing Europe. Government bonds issued by members of the Eurozone have fallen dramatically this year as investors grew more worried about a possible default in Greece and/or other heavily indebted European countries. More recently, even the region's economic powerhouse, Germany, has been forced to pay higher interest rates on its newly-issued debt. As large holders of this sovereign debt, European banks have also come under intense scrutiny as investors try to gauge the extent of their exposure to the crisis.

What investors may not realize is that the cash held in most U.S. money market funds may be directly exposed to a serious problem among one or more of these large European banks. Back in the good old days (say June of this year), more than 50 percent of U.S. "prime" money market funds' assets were invested in short-term debt issued by large European banks denominated in U.S. dollars. In addition to attractive yields, these banks allowed money market funds to diversify their holdings across a large number of issuers. And until recently, the credit quality of these banks was considered unassailable.

With the crisis in Europe intensifying in recent weeks, U.S. money market funds have been reducing their holdings in European bank debt. However, a recent report revealed that even as recently as September 30 prime money market funds still held more than 37 percent of their assets in European bank debt! The reasons for the apparent slow shift may range from inertia, continued faith in the quality of these assets, or the difficulty in reorienting such large portfolios without causing market panic.

At City National, we took aggressive steps to reduce our exposure to European bank debt in the very early stages of the crisis. In May of this year, our exposure in our Prime Money Market Fund was 46 percent. By July 31, we had reduced it to 21 percent, and we were completely free of European bank exposure by October 3.

We continue to believe in the quality and soundness of many of the large European banks, and we fully expect these banks to honor the commitments on their debt. However, in light of the unprecedented forces impacting the Eurozone economies and the sacrosanct goal of avoiding any fluctuation in principal value in our money market funds, those of us at City National believe it was the prudent step to take.

**Thanks and have a great week.**

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