First American Money Market Funds

Jim Palmer, CFA
Chief Investment Officer

Jeffrey Plotnik
Director of Money Market Fund Management

Mike Welle, CFA
Senior Portfolio Manager

What market conditions had a direct impact on the bond market this quarter?

During the quarter, corporate spreads and risk assets continued to perform well as investors maintained a generally positive tone. The inability of Congress to pass healthcare legislation increased uncertainty over the timing and magnitude of promised fiscal and regulatory reforms, leaving markets vulnerable at current valuations.

Economic Activity – First quarter U.S. GDP growth forecasts are in line with Q4/16's 2.1% rate. Employment conditions continued to improve, illustrated by the quarterly decline in U3 Unemployment rate to 4.5% from 4.7% and the corresponding decline in the U6 Underemployment Rate (which includes the total unemployed, plus all persons marginally attached to the labor force, plus total employed part-time for economic reasons) to 8.9% from 9.2%. Non-Farm payrolls added 533,000 jobs in the quarter despite the disappointing – and likely weather impacted – March addition of only 98,000 jobs. Household Employment outperformed Non-farm Payrolls by adding 889,000 jobs in the quarter. In another sign of employment strength, 561,000 people entered the Labor Force, improving the Labor Participation Rate to 63.0% from December's 62.7%. The climb in Labor Participation makes the decline in unemployment rates even more impressive, as it was clearly driven by an increase in the number of people employed rather than a reduction in the work force. U.S. Weekly Initial Jobless Claims – a helpful real-time indicator of employment conditions – averaged 246,000 in the quarter, a level last seen in the early 1970s. Consumer and Small Business Confidence remained at elevated post-election levels on increased hopes for lower taxes and reduced regulatory burdens. The year-over-year (yoy) Consumer Price Index reached 2.7% in February. The increase is primarily driven by the increase in oil and gas prices vs. last year's depressed energy levels. February's U.S. Personal Consumption Expenditure Core Index rose a milder 1.8% yoy. Given the consistent strength in employment conditions and a noticeable lack of broad sector bubbles in the real economy, the risk of a near term recession is low.

Credit Markets – Credit spreads benefitted from the investor optimism and risk-on bias prevalent since the November elections. The option-adjusted spread of the BofA Merrill Lynch 1-3 Year AAA-A U.S. Corporate Index tightened from 70 basis points (bps) to 61 bps over the quarter, adding additional return to the index's incremental coupon income. Corporate issuers took advantage of strong investor demand for spread product, printing $579B of term debt in the quarter – up 12.6% from last year's levels. Secondary market liquidity remained solid as markets were relatively calm during the quarter.

BofA Merrill Lynch Index	Q1 2017 Relative Perfomance*
1-3 Year AAA-A U.S. Corporates and All Yankees	0.60%
1-3 Year U.S. Treasury	0.26%

*Corporate index outperformed the Treasury index by 34 bps in the quarter

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The public rating environment for AAA- to A-rated bank and corporate credit remained relatively benign, although headline risk did touch high-quality issuers such as Reckitt Benckiser and Unilever.

BofA Merrill Lynch Index	Duration	Q1 2017 Relative Performance*
1-3 Year U.S. Treasury	~1.88 years	0.26%
1-5 Year U.S. Treasury	~2.71 years	0.372%

*Long index outperformed the short index by 11.2 bps in the quarter

The yield curve flattened in the quarter as short rates rose with the Federal Reserve (Fed) rate hike, while longer yields were relatively stable as investors began reducing their expectations for fiscal policy stimulus. In the quarter, one-year Treasury yields rose 20.6 bps while five-year yields actually fell by 0.6 bps, leading longer duration indexes to outperform their shorter counterparts.

Monetary Policy – The Fed raised its target rate 25 bps at the March 15th meeting. The Fed's Dot Plot forecast remained essentially unchanged, with median forecasts calling for two additional 25 bp rate hikes in 2017 and three more in 2018. The accompanying statement was little changed from December, with no indication the Fed felt it was falling behind in controlling inflation and inflationary expectations. The Fed's economic forecast was biased slightly upward from December and the Fed noted continued progress on meeting its employment and inflation goals. While policymakers are cognizant of the potential lift from fiscal policy, most appeared unwilling to alter their forecasts until more details are known on fiscal policy stimulus. Regarding the Fed's balance sheet, the minutes from the March 15th meeting revealed officials "judged that a change to the Committee's re-investment policy would be appropriate later this year." Given this guidance, our base case path would be a tapering of monthly re-investments after further rate hikes, with an announcement in late 2017 and implementation in 2018.

Fiscal Policy – The *promise* of tax cuts and fiscal policy changes rather than their actual *enactment* drove markets in the quarter. Republican ineffectiveness over the Affordable Care Act's repeal and replacement has increased investor concern about Washington's ability to enact meaningful and effective tax, infrastructure and regulatory legislation. President Trump has been more successful with targeted initiatives such as approving the Keystone pipeline and celebrating corporate investment in new plants and equipment – both of which can be done outside of the legislative process and can positively impact investor and business confidence. However, financial markets appear vulnerable should proposed fiscal stimulus and regulatory reforms not match expectations priced into current valuations.

What were the major factors influencing money market funds this quarter?

With money market reform in the rearview mirror, the market turned its full attention back to the Fed and the new economy under President Trump. The impact of President Trump's economic policies is still unclear; however, the Fed came through with a 25 bp hike at the March 15th Federal Open Market Committee meeting, lifting the fed funds rate to a range of 0.75% - 1.00%. The Fed has set the table for at least two more hikes in 2017. Money fund managers were aggressive in maximizing yields and were quick to respond to any economic data signaling a change in expected Fed policy with the potential to alter investment strategies.

First American Institutional Prime Obligations Fund
As the impact of money market reform reached its final stage, the First American Institutional Prime Obligations Fund found itself a much smaller fund in a much smaller universe. Management began the quarter cautiously, keeping a focus on liquidity and net asset value (NAV) stability while navigating the new world of floating NAVs. As the quarter progressed and the shareholder landscape became more certain, the fund began to ladder fixed-rate securities in the 60- to 90-day range and 6-month floating-rate instruments tied to one- and three-month LIBOR. The fund was able to benefit from rising LIBOR levels due to expected rate hikes, as well as credit spread widening resulting from a demand dislocation created by reform. By the end of the quarter we saw three-month LIBOR rise to 1.15% and one-month LIBOR rise to 0.98%. These factors helped to increase portfolio yield. As the quarter progressed with the credit environment stable and money market fund reform behind us, our main investment objective was to continue to enhance portfolio yield while judiciously extending the portfolio weighted average maturity (WAM) and weighted average life (WAL) in ways that minimized potential NAV volatility based on our credit, economic and interest rate outlook.

First American Retail Prime Obligations Fund
On July 18th, the First American Retail Prime Obligations Fund was successfully launched through the transfer of retail investors out of the First American Institutional Prime Obligations Fund. In total, about $1.8 billion was moved into the new retail fund at inception. Since then the fund has grown to about $2.7 billion in AUM. Due to the stable NAV and predictable shareholder base, portfolio management was able to capitalize on elevated LIBOR rates. Throughout the quarter, the fund invested in fixed- and floating-rate term securities from three months to one year in maturity, capturing yields ranging from 0.95% - 1.45%. As the quarter progressed, weekly variable-rate demand notes (VRDNs) became a drag on performance as the impacts of reform subsided – most were put back by the end of the quarter. The investment environment for prime funds remains attractive and we believe yields will be sustainable, making the sector an attractive short-term cash option for retail investors.

First American Government Obligations Fund
As we expected, government funds were significantly impacted by additional inflows from prime money market funds as the industry implemented the final stages of money market reform. We continued to see yield compression in GSE products as the surge in demand for the asset class exceeded supply. The Fed's Reverse Repo Program remains an important daily outlet for the influx of cash. We continued the purchase of Treasury and Agency securities with maturities as long as two years. We found value in nine- to 12-month fixed-rate securities that made sense within our anticipated pace of Fed tightening. We also capitalized on opportunities to purchase LIBOR-based floating-rate securities, maturing well into 2018 and 2019. We believe that floating-rate securities will perform well, as we expect LIBOR to remain elevated due to lighter demand in short bank and corporate debt coupled with higher overall interest rate expectations. We will seek to add value and employ this strategy as the market and portfolio metrics allow.

First American Treasury Obligations and U.S. Treasury Money Market Funds
Treasury funds experienced a similar investment environment to government funds. Treasury floating-rate note spreads, while compressing, still remained wide enough to offset the risk of a market flight to Treasury bills and remained an attractive addition to Treasury portfolios vs. overnight repo. In addition, we added economic value by purchasing fixed-rate term securities within 2a-7 guidelines, with yields that incorporated our interest rate forecast. Because Treasury portfolios are the most dependent on interest rate increases, anticipated Fed movement continued to have the largest impact on fund management decisions and overall yields.

First American Tax Free Obligations Fund
VRDN resets declined slightly early in the quarter, before moving higher in mid-March. The primary catalyst for the elevated levels was the change in the federal funds rate, as the tax-exempt money market universe continued to rely to some extent on crossover investors as marginal buyers. Seasonal factors – namely quarter end and the looming April income tax payment date – also contributed to resets ending the quarter at a high of 91 bps. We continued to manage the fund's WAM against our outlook for the Fed and, more importantly, the impact of these potential future moves on VRDN reset rates. Extension trades in the six- to eight-month area were effective at times in adding approximately 20-25 bps of income; however, as the curve flattened at the end of the quarter, we opted for a shorter strategy.

What near-term considerations will affect fund management?

In the coming quarters, we anticipate yields on non-government debt to remain elevated due to decreased demand for credit products. We believe institutional and retail prime obligations funds should continue to reap the benefits of reform-induced market dislocations and remain attractive short-term investment options. Outside of Fed rate increases, we foresee yields in the GSE and Treasury space increasing at a far less robust pace. We will continue to seek opportunities that arise from market volatility based on domestic and global economic data and Fed rate expectations.

For more information about the portfolio holdings, please visit

https://www.firstamericanfunds.com/home/portfolio-holdings.aspx.

[See next page for definitions and important disclosure information.]

Sources

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Federal Reserve, Chair's FOMC Press Conference Projections Materials, March 15, 2017, (www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20160316)

Federal Reserve, Chair's FOMC Press Conference Projections Materials, December 14, 2016, (www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20161214)

Definitions

Basis Point (bps) is one one-hundredths of a percentage point. This term is often used in describing changes in interest rates. For example, if a bond yield increases from 7.50% to 7.88%, it has moved up 38 basis points.
BofA Merrill Lynch 1-3 Year AAA-A U.S. Corporates & All Yankees Index is a subset of the BofA Merrill Lynch US Corporate & Yankees Index including all securities with a remaining term to final maturity less than three years and rated AAA through A3, inclusive.
BofA Merrill Lynch 1-3 Year U.S. Treasury Index is a subset of the BofA Merrill Lynch U.S. Treasury Index including all securities with a remaining term to final maturity less than three years.
BofA Merrill Lynch 1-5 Year U.S. Treasury Index is a subset of the BofA Merrill Lynch U.S. Treasury Index including all securities with a remaining term to final maturity less than five years.
Consumer Price Index (CPI) is an inflationary indicator that measures the change in the cost of a fixed basket of products and services, including housing, electricity, food, and transportation. The CPI is published monthly.
Duration is a measure of a security's price sensitivity to changes in interest rates. Securities with longer durations are more sensitive to changes in interest rates than securities of shorter durations.
Federal Funds Rate (fed funds rate) is the interest rate at which a depository institution lends immediately available funds (balances at the Federal Reserve) to another depository institution overnight.
Federal Reserve (Fed) is the United States central banking system. It is comprised of 12 regional central banks, known as the Federal Reserve Banks, which are owned by private banks. The Fed is governed by a 7-member Board of Governors, who regulates interest rates, availability of bank credit and sets other monetary policies such as legal reserve requirements for banks.
Fed Reverse Repo Facility is a repo program in which the Fed sells Treasury or agency securities to approved counterparties with an agreement to repurchase them back from the same counterparties at a specified price and date in the future.
Government Sponsored Enterprise (GSE) is a privately held corporation with a public purpose, created by the U.S. Congress to reduce the cost of capital for certain borrowing sectors of the economy. GSEs carry the implicit backing of the U.S. Government, but they are not direct obligations of the U.S. Government. Examples of GSEs include Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, Federal Farm Credit Bank.
Inflation is defined as a sustained increase in the general level of prices for goods and services. It is measured as an annual percentage increase. As inflation rises, every dollar you own buys a smaller percentage of a good or service.
LIBOR (London Interbank Offered Rate) is the interest rate at which banks can borrow funds from other banks in the London interbank market. It is the world's most widely used benchmark for short-term interest rates.
LIBOR Rates are rates that the most creditworthy international banks dealing in eurodollars charge each other for large loans. The LIBOR rate is usually the base for other large eurodollar loans to less creditworthy corporate and government borrowers.
Liquidity is a characteristic of a security or commodity with enough units outstanding to allow large transactions without a substantial drop in price.
Maturity is the date on which the principal amount of a note, draft, acceptance, bond, or other debt instrument becomes due and payable. Also, termination or due date on which an installment loan must be paid in full.
Monetary Policy is the actions of a central bank, currency board or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.
Personal Consumption Expenditures Index is a measure of price changes in consumer goods and services. It is essentially a measure of goods and services targeted toward individuals and consumed by individuals.
Securities and Exchange Commission (SEC) is the federal agency that regulates the registration and distribution of mutual funds.
Treasury is negotiable debt obligation of the U.S. government, secured by its Full Faith and Credit and issued at various schedules and maturities. The income from Treasury securities is exempt from state and local, but not federal, taxes.

U.S. Treasury Note is a marketable U.S. government debt security with a fixed interest rate and a maturity between one and 10 years. Treasury notes can be bought either directly from the U.S. government or through a bank.

Variable Rate Demand Note (VRDN) is a debt instrument that represents borrowed funds that are payable on demand and accrue interest based on a prevailing money market rate, such as the prime rates. The interest rate applicable to the borrowed funds is specified from the outset of the debt and is typically equal to the specified money market rate plus an extra margin. Also referred to as a variable rate demand obligation (VRDO).

Weighted Average Life, also known as Weighted Average Final Maturity, (WAL) is the average time to maturity of all the securities held in the portfolio, weighted by each security's percentage of total investments. Unlike WAM, the WAL calculation takes into account the final maturity date for each security held in the portfolio. WAL measures a fund's sensitivity to potential credit spread changes.

Weighted Average Maturity (WAM) is the average time to maturity of all the securities held in the portfolio, weighted by each security's percentage of total investments. This calculation takes into account the final maturity date for a fixed income security and the interest rate reset date for a floating rate security, which is allowed by Rule 2a-7 provisions. WAM measures a fund's sensitivity to interest rate changes.

Yield Curve is a line tracing relative yields on a type of bond over a spectrum of maturities ranging from three months to 30 years.