First American Money Market Funds

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

During the quarter, corporate and asset-backed spreads continued to tighten on strong investor demand, while short U.S. Treasury rates rose on the back of the June 14th rate hike. On the economic front, employment remained solid while inflation measures weakened vs. the Federal Reserve's (Fed's) 2% target level.

Economic Activity – Second quarter U.S. GDP growth is expected to improve on the first quarter's disappointing 1.4% pace. Employment conditions reflected continued strength as Non-farm Payrolls added a healthy 581,000 jobs and the U3 Unemployment Rate fell 0.1% to 4.4% in the quarter. Initial Jobless Claims – an excellent indicator of current employment conditions – remained near 40-year lows. Despite solid labor growth, Average Hourly Earnings remained well-behaved with workers seeing only 2.5% year-over-year (yoy) gains, down from March's 2.6% level. The moderate wage gains were in line with the softening of most of the quarter's inflation indicators. May's U.S. Consumer Price Index fell to 1.9% yoy vs. March's 2.4% reading on falling oil and commodity prices. May's Core Personal Consumption Expenditure Index fell to 1.39% from March's 1.56% reading. June ISM Manufacturing and Non-Manufacturing Indexes surprised to the upside with readings of 57.8 and 57.4, respectively, reflecting strong growth in both sectors. 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 appears low.

Credit Markets – Credit spreads tightened further as investors shrugged off the general dysfunction in Washington and the dimming prospects for fiscal and tax reforms. The option-adjusted spread of the BofA Merrill Lynch 1-5 Year AAA-A U.S. Corporate Index tightened from 68 basis points (bps) to 60 bps over the quarter, adding additional return to the index's incremental coupon income. Secondary market liquidity remained robust as market volatility was relatively low during the quarter.

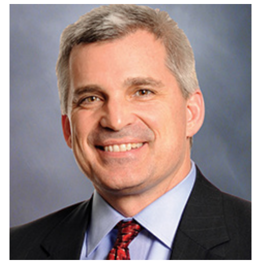
BofA Merrill Lynch Index	Q2 2017 Relative Perfomance*
1-3 Year AAA-A U.S. Corporates and All Yankees	0.496%
1-3 Year U.S. Treasury	0.174%

*Corporate index outperformed the Treasury index by 32.2 bps in the quarter

The public rating environment for AAA- to A-rated bank and corporate credit remained relatively benign, although the Canadian and Australian banking sectors experienced one-notch downgrades in the quarter on growing domestic mortgage and housing concerns.

BofA Merrill Lynch Index	Duration	Q2 2017 Relative Performance*
1-3 Year U.S. Treasury	~1.89 years	0.174%
1-5 Year U.S. Treasury	~2.69 years	0.379%

*Long index outperformed the short index by 20.5 bps in the quarter



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The U.S. Treasury yield curve flattened in the quarter, with one-year yields climbing 21.1 bps while five-year yields actually fell 3.3 bps. The flattening of the curve benefitted the three- to five-year area of the curve and fueled the outperformance of longer benchmarks vs. shorter counterparts. Absolute short yields continued to rise following the June 14th rate hike.

Monetary Policy – The Fed raised its target rate 25 bps at the June 14th meeting, the third increase since November. The Fed's updated Dot Plot median forecast called for one additional fed funds rate hike in 2017 with three additional hikes in 2018. The median longer run forecast called for a terminal fed funds rate of 3.0%. Despite the Fed's guidance, fed funds futures placed only a 16% chance of a September rate hike and a 52% probability of one additional rate hike by the end of 2017. Investor doubts were driven by recent price data indicating inflation levels had declined somewhat below the Fed's 2% goal. Also in the June 14th statement, the Fed noted it expects to begin implementing a balance sheet normalization plan this year. The normalization program would gradually reduce Fed Treasury and mortgage-backed securities holdings by decreasing reinvestment of principal payments from those securities. The consensus from market strategists for the future path of Fed policy normalization seemed to coalesce around a September move on balance sheet reduction and a third 25 bp rate hike in December.

Fiscal Policy – Investor expectations for promised tax cuts and fiscal policy reforms waned in the quarter, as the White House and Congress struggled to come to agreement on most key issues, including a repeal and replacement of the Affordable Care Act. Initial optimism was high for fiscal reforms coming as early as August; however, Administration officials and Republican leaders have publically tempered expectations and now most expect any reforms to come late in 2017 or early 2018. The Trump Administration has made progress on reducing the regulatory burdens placed on the economy following the financial crisis at the administrative level rather than through legislation.

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

The market's full attention was on the Fed and the potential impacts of President Trump's waning momentum for imminent policy changes. While the impact of President Trump's economic policies is still unclear, the Fed did come through with another 25 bp hike at the June 14th Federal Open Market Committee meeting, lifting the fed funds rate to a range of 1.00% - 1.25%. The Fed has set the table for at least one more hike in 2017, coupled with a plan to start unwinding a portion of its $4 trillion balance sheet. Money fund managers were aggressive in maximizing yields and were quick to respond to any economic data signaling a change in expected Fed policy.

First American Institutional Prime Obligations Fund

As money market reform came and went, the First American Institutional Prime Obligations Fund found itself a much smaller fund in a much smaller universe. Management began the year cautiously, keeping a focus on liquidity and net asset value (NAV) stability while navigating the new world of floating NAVs. As the year progressed and the shareholder landscape became more certain, the fund began to ladder fixed-rate securities in the 60- to 90-day range and six- to nine-month floating-rate instruments. The fund was able to benefit from rising LIBOR levels due to expected rate hikes. The reform-influenced demand dislocations that widened credit spreads early in the year have dissipated, as issuers found the necessary funding outlets. This tempered the ability of prime assets to outperform other assets classes by the wide margins experienced early in the year. However, by the end of the second quarter, three-month LIBOR rose to 1.299% and one-month LIBOR rose to 1.224% in response to Fed tightening. As the quarter progressed with the credit environment stable and the impacts of 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

Just as with the institutional prime universe, the reform-influenced demand dislocations that widened credit spreads early in the year tempered the ability of prime assets to out-perform other assets classes by the wide margins experienced earlier. However, by the end of the second quarter, three-month LIBOR rose to 1.299% and one-month LIBOR rose to 1.224% in response to Fed tightening. Due to the stable NAV and predictable nature of the retail shareholder base, portfolio management continued to capitalize on the rising interest rate environment reflected in the fed funds rate and LIBOR yields. Throughout the quarter, the fund invested in fixed- and floating-rate term securities from three months to one year in maturity, capturing yields which were accretive. As the quarter progressed and the impacts of reform subsided, weekly variable-rate demand notes (VRDNs) became a drag on performance and most were put back by quarter end. The investment environment for prime funds remained 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 continued to hold a majority of the cash that migrated as a result of money market fund reform. Yield compression in agency products persisted, as basic supply and demand dynamics impacted prices. The Fed's Reverse Repo Program (RRP) remained an important outlet for the influx of cash and a mechanism for rate control. We continued the purchase of Treasury and agency securities with maturities as long as two years. We found value in three- to six-month fixed-rate securities that made sense within our anticipated pace of Fed tightening. We also capitalized on opportunities to purchase floating-rate securities, maturing well into 2019. We believe that floating-rate securities will perform well, as we expect LIBOR to remain elevated relative to the RRP and government securities due to lighter demand in short bank and corporate debt coupled with higher overall interest rate expectations. We will seek to add value and continue to 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, were 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 Retail Tax Free Obligations Fund

The WAM of the Fund declined to 10 days, as we showed a strong preference toward VRDNs during the quarter. Increased liquidity was valuable as income tax payments led to outflows from tax-free money funds in April. Although VRDN resets declined in May as flows stabilized, we continued to favor them over fixed-rate investments due to our forecast for further increases to the fed funds rate. This strategy was validated as the Fed moved rates higher at the June meeting. We anticipate one more increase is on the horizon before year end, perhaps as soon as September.

What near-term considerations will affect fund management?

In the coming quarters, we anticipate yields on non-government debt to remain elevated relative to government securities but suspect the term premiums available during reform are gone. Even with some of the yield benefits fading, we believe institutional and retail prime obligations funds remain attractive short-term investment options for investors seeking higher yields on cash positions while still assuming minimal credit risk. Yields in the agency and Treasury space are largely dependent on Fed policy. We will continue to seek opportunities – in all asset classes – 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.

Sources

Bloomberg

Federal Reserve, Chair's FOMC Press Conference Projections Materials, June 14, 2017, (www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20170614.pdf)

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

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 1-5 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 five 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.
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.
ISM Manufacturing Index is a monthly index released by the Institute of Supply Management, an industry association for supply management professionals, which tracks manufacturing activity, including employment, production inventories, new orders and supplier deliveries. This is index is a key measure of the national economy.
ISM Non-Manufacturing Index is a monthly index of more than 400 non-manufacturing firms' purchasing and supply executives within 60 sectors across the nation, released by the Institute of Supply Management (ISM).The ISM Non-Manufacturing Index includes seasonally adjusted figures for several of its components, unlike the ISM Manufacturing Index.
Laddering is a technique for reducing the impact of interest rate risk by stucturing a portfolio with different bond issues that mature at different dates.
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.
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.