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 the positive environment for credit and risk assets. Treasury yields shifted during the quarter, as investors drove rates down on declining inflation concerns in July and August before reversing and pushing rates higher on stronger September data. The U.S. economy continued to show consistent if somewhat modest growth and is now being joined by strength in global economies, Europe in particular.

Economic Activity – After the second quarter U.S. GDP 3.1% growth rate surprised markets to the upside, third quarter growth is expected to ease closer to 2.0%, as Hurricanes Harvey and Irma negatively impacted consumer spending and economic activity in the southern states. While the near-term hurricane impact is decidedly negative, fourth quarter spending is expected to rebound – along with construction and employment – as the rebuild of impacted areas begins. Employment conditions remained solid in the quarter, although September's employment data was a mix of negative and positive developments. Non-farm Payrolls fell 33,000 jobs – the first monthly decline in seven years – and 1.47 million people reported they could not work due to bad weather. This weak hurricane-impacted data was more than offset by declines in the U3 and U6 Unemployment Rates to 4.2% and 8.3%, respectively. The improvement was due to robust September gains of 906,000 in Household employment, which swamped the 575,000 increase in the Labor Force to drive unemployment rates down. Average Hourly Earnings rose 2.9% year-over-year (yoy), partially driven by the hurricane-related 111,000 employment decline in the leisure and hospitality sector, which tends to have lower paying jobs. Core inflation measures continued to decline, as August's Core Personal Consumption Expenditure Index fell to 1.29% yoy from May's 1.47% reading. Headline inflation – which can be more affected by weather and supply chain disruptions – was steady, as August's U.S. Consumer Price Index matched May's 1.9% yoy reading. 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 continued to tighten in a measured and seemingly unaltered path, illustrated by the option-adjusted spread of the BofA Merrill Lynch 1-5 Year AAA-A U.S. Corporate Index tightening from 60 basis points (bps) to 52 bps during the quarter. Almost every factor worked in credit's favor in the quarter; low market volatility, minimal headline risk events, muted negative rating activity and positive supply / demand dynamics all added to the market's overall risk-on bias.

BofA Merrill Lynch Index	Q3 2017 Relative Perfomance*
1-3 Year AAA-A U.S. Corporates and All Yankees	0.304%
1-3 Year U.S. Treasury	0.238%

*Corporate index outperformed the Treasury index by 6.6 bps in the quarter

Lower-rated credit benefitted the most from the market's risk-on mentality, with the BofA Merrill Lynch BBB corporate index outperforming the AAA-A index by 40.0 bps in the one- to three-year space.

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First American Funds.

BofA Merrill Lynch Index	Duration	Q3 2017 Relative Performance*
1-3 Year U.S. Treasury	~1.88 years	0.238%
1-5 Year U.S. Treasury	~2.68 years	0.286%

*Long index outperformed the short index by 4.8 bps in the quarter

Over the entire third quarter, the short-term U.S. Treasury yield curve flattened, with two-year yields climbing 10.1 bps while five-year yields rose only 4.8 bps. However, yields actually fell across the short-term curve from July 1st through August 31st as concerns over declines in inflation measures lowered the probability of additional 2017 rate hikes. Stronger September economic data and more hawkish signals from the Federal Reserve (Fed) jumped two- and five-year Treasury yields 15.7 and 23.4 bps, respectively. In general, longer benchmarks slightly outperformed shorter benchmarks, as the benefits from a flattening yield curve and incremental coupon income overcame the negative impact of overall higher yields.

Monetary Policy – As expected, the Fed declined to raise its target rates at either the July 26th or September 20th meetings. At the September meeting, the Fed formally announced its plan to begin the wind-down of its balance sheet through the gradual reduction of principal re-investments of maturities and mortgage paydowns. The Fed will begin tapering its purchases by $10 billion per month in the fourth quarter and gradually increase the amount quarterly until reaching a maximum of $50 billion per month by the end of 2018. The policy adjustment had been previously signaled and anticipated, resulting in virtually no market reaction to the announcement. The Fed's September Dot Plot for future federal funds rate expectations indicated the Fed would raise rates 25 bps one more time in 2017 – the December 13th meeting being the most likely – with three additional 25 bp rate hikes in 2018. Investors believe the Fed will be less aggressive, with quarter-end fed funds futures indicating a 70% probability of a single 2017 rate hike and only one additional hike in 2018. The composition of the Federal Reserve Board of Governors is in flux, with Chairperson Janet Yellen's term expiring in January 2018 and four open seats after Vice-Chairman Stanley Fischer retires in October. The number of vacancies gives President Trump a unique opportunity to shape the Federal Reserve while also complicating investor forecasts for monetary policy.

Fiscal Policy – The Trump Administration reached an agreement with Congress – after unexpectedly agreeing to proposals from Democrats – which extended government funding through December 8th and raised the debt ceiling to the level of outstanding debt on that date. The legislation allows the U.S. Treasury to use extraordinary measures, which should push out the government's ability to borrow additional funds for four to six months depending upon the level of tax receipts in early 2018. The urgent need for hurricane relief for Texas, Florida and Puerto Rico was one of the political driving forces behind the surprisingly quick resolution to the funding and debt issues. The other key force was the Trump Administration's desire to focus on tax cuts and reform. The details of any potential tax plan are still unclear, although some key points include a 20% corporate tax rate offset by the elimination of various – and popular – tax deductions and the repatriation of foreign corporate profits. The uncertainty over the final form and scale of fiscal stimulus and the degree to which it is baked into current market asset prices leaves risk assets vulnerable should policymakers fail to reach a meaningful agreement.

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

During the third quarter the market's attention was divided between a potential debt ceiling crisis, President Trump's foreign and domestic policy discussions and any indications from Janet Yellen and the Fed regarding the future tightening of monetary policy. By the end of the quarter the potential impact of President Trump's economic policies was still unclear; however, the market began to price in one more rate hike by the end of 2017. This increased expectation of another rate hike provided fund managers with opportunities to capture additional yield as the curve began to steepen.

First American Institutional Prime Obligations Fund

One year post-reform, the First American Institutional Prime Obligations Fund remains a much smaller fund in a much smaller universe. However, shareholders are adjusting well to the new money market landscape and the First American Institutional Prime Obligations Fund has found a solid shareholder base. With comfort around the fund's base size, management was able to invest accordingly, seeking to best take advantage of the investment environment. The fund continued 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 elevated London Interbank Offered Rate (LIBOR) levels relative to Repo and Treasury / agency products to achieve higher yields. However, 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 third quarter, three-month LIBOR rose to 1.334% and one-month LIBOR rose to 1.232% in response to expected 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 net asset value (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 receded and have now tempered the ability of prime assets to out-perform other assets classes by the wide margins experienced earlier. However, by the end of the third quarter, three-month LIBOR rose to 1.334% and one-month LIBOR rose to 1.232% in response to expected 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 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. 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 the majority of 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 nine-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 still positive and 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

Municipal market conditions including heavy reinvestment needs from bond coupons and maturities, a relatively flat yield curve and rich valuations encouraged short term bond funds and separately managed accounts to become bigger players in the variable-rate demand note (VRDN) market. This additional demand from non-traditional VRDN buyers suppressed SIFMA resets for the majority of the period. Note issuance increased significantly later in the quarter with several large municipalities accessing the market. While these notes offered incrementally higher yields, portfolio management was reluctant to extend the fund's WAM as we expect VRDN's to outperform over a longer time horizon.

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 both the 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 will remain influenced by Fed policy as well as the strong demand from investors in this space. 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.

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

For more information about the portfolio holdings, please visit
https://www.firstamericanfunds.com/home/portfolio-holdings.aspx.

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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.
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.
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.
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.
SIFMA is the Securities Industry and Finamcial Markets Association, a United States based trade group representing banks, brokerages and asset management firms.

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.
U3 Unemployment Rate is the commonly-referred to unemployment rate. It includes people out of work who have been actively seeking employment over the last four weeks.
U6 Unemployment Rate is the group of people who are unemployed but marginally attached to the workforce, meaning they are available to work but not looking, or who work part-time when they wish to be working full time.
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.