First American Money Market Funds

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

Positive economic data bolstered risk assets, tightened credit spreads and sent Treasury yields higher in the quarter. The Federal Reserve (Fed) continued to normalize monetary policy through rate hikes and balance sheet reduction at a self-described gradual pace. Trade conflicts continue to influence markets, but the impact on the real economy has been muted to date.

Economic Activity – While down from the second quarter's robust 4.2% growth rate, U.S. Gross Domestic Product is forecasted to grow in the 3.0% to 3.5% range in the fourth quarter, a healthy pace expected to continue into 2019. September's ISM Manufacturing and Non-Manufacturing readings of 59.8 and 61.6, respectively, reflect considerable strength and argue for a sustainable expansion. The labor market showed no sign of losing momentum with the U3 Unemployment Rate falling to 3.7% and Initial Jobless Claims averaging 211,000 in the quarter – both near 49-year lows. September's Non-farm Payroll (NFP) reading of +134,000 jobs was soft relative to expectations – likely weakened by Hurricane Florence – but was offset by a positive revision of 87,000 jobs in July and August's readings. Overall, NFP added a healthy 569,000 jobs in the quarter. The Civilian Labor Force fell 214,000 workers in the quarter while Individuals Not in the Labor Force rose a disappointing 862,000. Despite the combination of employment growth and a decline in available workers, September's Average Hourly Earnings – a widely watched harbinger of wage-push inflation pressures – rose just 0.3% month-over-month (MoM) and 2.8% year-over-year (YoY). Inflation measures have essentially reached the Fed's 2% target, with August's Consumer Price Index reaching 2.7% YoY and August's Core Personal Consumption Expenditure Index – the Fed's preferred inflation measure – up 2.0% YoY. Leading indicators suggest the risk of a U.S. recession is low through 2020. Near-term risks to the expansion and financial market stability include overly-hawkish Fed policies, emerging market stress and a meaningful escalation of trade conflicts.

Credit Markets – Positive economic data and a general risk-on investor mentality tightened credit spreads across the board, with lower rated issuers performing particularly well. Three-month LIBOR began trending higher on the September 26th rate hike, but overall gains after the first quarter's big 61.7 basis point (bps) move upward have been subdued. Market technicals are supportive of corporate credit, with issuance declining as repatriated profits are being utilized to support dividends, share repurchases and paying off maturing debt.

Credit Spread Changes

ICE BofAML Index	OAS* (bps) 6/30/18	OAS* (bps) 9/30/18	Change (bps)
1-3 Year U.S. Agency Index	8	5	-3
1-3 Year AAA-A U.S. Corporate and Yankees	18	14	-4
1-3 Year AA U.S. Corporate and Yankees	51	38	-13
1-3 Year A U.S. Corporate and Yankees	64	48	-16
1-3 Year BBB U.S. Corporate and Yankees	95	77	-18
0-3 Year AAA U.S. Fixed-Rate ABS	48	34	-14
			*OAS = Option-Adjusted Spread

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Option-Adjusted Spread (OAS) measures the spread of a fixed-income instrument against the risk-free rate of return. U.S. Treasury securities generally represent the risk-free rate.

First American Funds.

Corporate Credit Relative Performance

ICE BofAML Index	Q3 2018 Relative Performance*
1-3 Year AAA-A U.S. Corporate and Yankees	0.572%
1-3 Year BBB U.S. Corporate and Yankees	0.812%
1-3 Year U.S. Financial Index	0.753%
1-3 Year U.S. Non-Financial Index	0.697%
1-3 Year U.S. Treasury	0.195%

**AAA-A Corporate index outperformed the Treasury index by 37.7 bps in the quarter*

**AAA-A Corporate index underperformed the BBB Corporate index by 24 bps in the quarter*

**U.S. Financials outperformed U.S. Non-Financials by 5.6 bps in the quarter*

Buoyed by strong GDP numbers and investor demand for risk assets, corporate credit and spread product handily outperformed comparable-duration Treasuries in the quarter with the BBB sector performing particularly well. Credit spreads tightened virtually across the board, adding further return to the embedded coupon income advantage. Not unexpectedly given the favorable credit environment, financials outperformed their industrial counterparts. Technicals provided support for corporate debt performance, as year-to-date through August, new issue investment-grade corporate debt issuance has declined 17.3% from $1,145 billion in 2017 to $947 billion.

Yield Curve Shift

U.S. Treasury Curve	Yield Curve 6/30/18	Yield Curve 9/30/18	Change (bps)*
3 Month	1.912%	2.196%	28.4
1 Year	2.312%	2.563%	25.1
2 Year	2.528%	2.819%	29.1
3 Year	2.622%	2.883%	26.1
5 Year	2.738%	2.953%	21.5
10 Year	2.860%	3.061%	20.1

**Interest rates rose across the yield curve in the quarter*

**U.S. Treasury Yield Curve from 1 to 5 years flattened 3.6 bps*

**U.S. Treasury Yield Curve from 2 to 10 years flattened 9.0 bps*

Duration Relative Performance

ICE BofAML Index	Duration (years)*	Q3 2018 Relative Performance**
0-1 Year U.S. Treasury	0.50	0.491%
0-2 Year U.S. Treasury	1.00	0.390%
0-3 Year U.S. Treasury	1.42	0.293%
1-3 Year U.S. Treasury	1.87	0.195%
1-5 Year U.S. Treasury	2.64	0.051%

**Duration estimate is as of 9/30/18*

***In general, shorter duration indexes outperformed longer indexes*

Continuing a general trend in 2018, U.S. Treasury yields rose across the curve in the quarter, allowing short-duration strategies to outperform their longer-term counterparts. The upward jump in rates reflects the late June and September 26th Fed rate hikes as well as the anticipation of additional hikes in December and 2019. The yield curve flattened in the quarter, as the Fed-induced increase in short-term rates outpaced the rise in longer-term rates, which tend to move on overall growth and inflation outlooks.

Monetary Policy – As fully expected by the markets, the Fed raised the federal funds (fed funds) target range 25 bps to 2.00% - 2.25% at the September 26th meeting. The accompanying Fed Dot Plot predicted one additional rate hike in 2018 and three more in 2019. The Fed remains upbeat on employment conditions, forecasting a 3.5% U3 Unemployment Rate for 2019 and 2020 – far below the expected longer run rate of 4.5%. Core PCE Inflation is projected to increase to 2.1% in 2019 and 2020, reflecting the Fed's confidence in sustaining its 2% longer run goal while downplaying the risk of meaningfully higher inflation. In the September 26th statement, the Fed continued to expect further gradual increases in the fed funds rate – which the market has interpreted as maintaining the current every other meeting pace – while removing language stating the stance of monetary policy remains accommodative. Fed Chairman Powell seemed to contradict the latter comment when in an October 3rd interview he suggested "interest rates are still accommodative" and that the Fed "may go past neutral. But we're a long way from neutral at this point, probably." The contradiction alarmed investors, lifting interest rates further and steepening the yield curve. The Fed continues to taper principal re-investments of maturities and mortgage pay downs in its portfolio, ultimately reaching its maximum cap of $50 billion in securities purchase reductions per month in the fourth quarter. Since the Fed's balance sheet reduction program began in October 2017, securities held outright and reserve balances have fallen $242.9B and $340.9B, respectively.

Fiscal Policy – The Trump Administration continued to aggressively pursue revised trade agreements through both enacting and threatening large scale tariffs. In a positive development for markets, the U.S., Canada and Mexico agreed to a revised NAFTA agreement – now called USMCA. While the differences may be relatively minor, the agreement was hailed as a victory by the Trump Administration and seemed to bolster the President's resolve on trade conflicts. Hopes for an early resolution to trade hostilities with China have faded, particularly after a Bloomberg News report of Chinese hacking of microchips in U.S. computer networks and President Trump's accusation of Chinese meddling in U.S. elections. Recent corporate tax reductions continue to work their way through the economy and financial markets, supporting equity markets with higher expected after-tax returns and impacting corporate capital flows, including new corporate debt issuance. Net U.S. Treasury issuance is expected to increase significantly in the coming quarters as tax cuts and increased federal spending push annual fiscal deficits toward $1 trillion.

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

The third quarter of 2018 continued to deliver strong economic data, solidifying the market's expectations for higher interest rates. As anticipated, the Fed increased rates another 25 bps on September 26th, making the range 2.00% to 2.25% and fed funds futures are indicating an 80% probability of another 25 bp hike in December. Deficit spending coupled with balance sheet normalization kept T-bill / T-note supply plentiful, which also added pressure to front-end yields. White House policies kept the market on its toes, but overall the quarter presented no real rate surprises.

First American Institutional Prime Obligations Fund

As is the case with the larger institutional prime money market fund industry, the First American Institutional Prime Obligations Fund remains a smaller fund in a smaller universe. However, shareholders have adjusted to the new floating net asset value (NAV) landscape and the First American Institutional Prime Obligations Fund has found a solid and expanded shareholder base. With comfort around the fund's base size, management invested accordingly, seeking to take advantage of the dynamic investment environment. The fund laddered fixed-rate securities in the 30- to 90-day range and purchased six- to nine-month floating-rate instruments. Most fixed-rate investments were strategically purchased to mature around key Fed meetings to better manage NAV stability in the rising rate environment. Throughout the quarter the very front end of the yield curve flattened, as LIBOR was slow to respond to expected rate hikes and issuers managed to closely match supply with anticipated front-end demand. This resulted in somewhat less robust yields in the prime sector vs. what was produced in the first half of 2018. Management was more active purchasing one-month LIBOR floaters due to the rather stagnant behavior of the three-month LIBOR index – during the quarter, three-month LIBOR only rose 6 bps to 2.395% and one-month LIBOR rose 17 bps to 2.26%. With the credit environment stable, our main investment objective was 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
Similar to the institutional prime universe, the First American Retail Prime Obligations Fund continued with its core strategy of purchasing short-term fixed-rate securities in the 30- to 90-day range and longer term floating-rate instruments in the six-month to one-year range. The First American Retail Obligations Fund benefited from the same market influences as the institutional fund and third quarter fund yields reflected the increase in three- and one-month LIBOR to 2.395% and 2.26%, respectively. Due to the stable NAV and predictable nature of the retail shareholder base, portfolio management was able to better capitalize on the rising interest rate environment reflected in one-month LIBOR yields. 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
Government funds continued to benefit from the cash migration resulting from money market fund reform. Since the first quarter, Treasury, agency and dealer repo supply have kept government money market fund yields elevated. While the Fed's Reverse Repo Program (RRP) remained an important rate control tool, it was utilized infrequently outside of quarter end, as dealer repo was plentiful and significantly cheaper. The fund often participated in bi-weekly Federal Home Loan Bank discount note auctions to capitalize on one- to six-month discount note opportunities that outperformed repo and made sense within our anticipated pace of Fed tightening. We also found value in Treasury and agency securities with maturities out to two years. We purchased floating-rate securities maturing well into 2020 that were diversified between one- and three-month LIBOR, fed funds, three-month T-bill and Secured Overnight Financing Rate indexes. We believe that floating-rate securities will perform well, as we expect LIBOR to remain elevated relative to the RRP and other government securities. We also anticipate the alternative indexes listed above will provide a meaningful spread to overnight repo and will respond quickly to changes in interest rates. 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 and durations that best 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
July is known to be the highest single month of the year for municipal bond maturities and coupon payments and broker dealers were aggressive in taking full advantage of this opportunity to lower resets. Over the first few weeks of the quarter, weekly variable-rate demand note (VRDN) rates fell a combined 57 bps and some investments resetting daily tumbled over 100 bps! These sharp moves were met with resistance in August, as investors responded with over $8 billion in industry-wide fund redemptions. Ultimately SIFMA rebounded and finished the quarter 5 bps higher than where it began. The Fed rate hike in September did not have an immediate impact on VRDN rates, although we observed a back-up in one-year paper of nearly 30 bps during September. The move higher in these fixed maturities may in part be an acknowledgement of Fed activity but also likely reflects the fading municipal reinvestment demand.

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 in the face of rising interest rates, positive credit curve and a spirited political environment. We believe both

First American Institutional and Retail Prime Obligations Funds will 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 and U.S. T-bill / T-note supply. We expect continued 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 / market data and Fed rate expectations. In terms of factors impacting the First American Retail Tax-Free Obligations Fund, we expect both a slightly positive municipal supply on a "net" basis over the next couple months and another hike from the Federal Reserve in December to work together to push rates higher. We believe the Fund is positioned well to capture additional income from higher resets with over 95% of the portfolio comprised of variable rate securities. We are also seeing value in two- to three- month tax-exempt commercial paper at current yields of 20 - 25 bps over SIFMA and we will be looking to increase these allocations as portfolio metrics and market conditions allow.

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

Sources

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FOMC Statement and materials, September 26, 2018
Municipal Market Monitor
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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.
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 seven-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.
ICE BofAML 0-1 Year U.S. Treasury Index tracks the performance of U.S. dollar denominated sovereign debt publicly issued by the U.S. government in its domestic market with maturities less than one year.
ICE BofAML 0-2 Year U.S. Treasury Index tracks the performance of U.S. dollar denominated sovereign debt publicly issued by the U.S. government in its domestic market with maturities less than two years.
ICE BofAML 0-3 Year AAA U.S. Fixed Rate Asset Backed Securities Index is a subset of ICE BofAML U.S. Fixed Rate Asset Backed Securities Index including all securities with a remaining term to final maturity less than three years and rated AAA.
ICE BofAML 0-3 Year U.S. Treasury Index tracks the performance of U.S. dollar denominated sovereign debt publicly issued by the U.S. government in its domestic market with maturities less than three years.
ICE BofAML 1-3 Year AAA-A U.S. Corporates & All Yankees Index is a subset of the BofA Merrill Lynch U.S. Corporate & Yankees Index including all securities with a remaining term to final maturity less than three years and rated AAA through A3, inclusive.
ICE BofAML 1-3 Year AA U.S. Corporates & All Yankees Index is a subset of the BofA Merrill Lynch U.S. Corporate & Yankees Index including all securities with a remaining term to final maturity less than three years and rated AA1 through AA3, inclusive.
ICE BofAML 1-3 Year BBB 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 BBB1 through BBB3, inclusive.
ICE BofAML 1-3 Year Single-A U.S. Corporates & All Yankees Index is a subset of the BofA Merrill Lynch U.S. Corporate & Yankees Index including all securities with a remaining term to final maturity less than three years and rated A1 through A3, inclusive.
ICE BofAML 1-3 Year U.S. Agency Index is a subset of ICE BofAML U.S. Agency Index including all securities with a remaining term to final maturity less than three years.
ICE BofAML 1-3 Year U.S. Financial Index is a subset of ICE BofAML U.S. Corporate Index including all securities of Financial issuers with a remaining term to financial maturity less than three years.
ICE BofAML 1-3 Year U.S. Non-Financial Corporate Index is a subset of ICE BofAML U.S. Non-Financial Index including all securities with a remaining term to final maturity less than three years.
ICE BofAML 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.
ICE BofAML 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.
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.
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 Financial Markets Association, a United States based trade group representing banks, brokerages and asset management firms.
Secured Overnight Financing Rate (SOFR) is part of the LIBOR reform introduced this year by the U.S. Alternative Reference Rates Committee. For the U.S. rate market, SOFR is calculated using actual transactions in repurchase agreements collateralized with U.S. Treasuries and not with 'predictive transactions' as with LIBOR.
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.
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.
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.

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