First American Money Market Funds

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

Financial markets recovered in the second quarter despite predictions for a historic plunge in U.S. Gross Domestic Product (GDP). Investors took confidence in the Federal Reserve's (Fed) robust response to the economic and market dislocation caused by COVID-19 and rolling economic shutdowns. Fiscal stimulus, primarily in form of the Coronavirus Aid, Relief and Economic Security Act (CARES), provided strong support for consumer income levels as unemployment rates soared.

Economic Activity – Second quarter U.S. GDP is expected to fall in the area of 35% on an annualized quarter-over-quarter basis, as activity collapsed from the economic shutdowns implemented to combat the spread of COVID-19. Despite the sharp decline in growth, employment conditions improved deeper in the quarter as portions of the country opened for business. After a disastrous April loss of 20.787 million jobs, Non-farm Payrolls grew 2.699 million in May and 4.800 million in June with both numbers beating expectations by a wide margin. After peaking at 14.7% in April, the U-3 U.S. Unemployment Rate fell to 11.1% in June. Initial Jobless Claims declined fourteen straight weeks after peaking at 6.867 million for the week ending March 24th. Unfortunately, the July 3rd Claims print was a stubbornly high 1.314 million, and for context, the average reading in February was 214,000 which was close to 50-year lows. Both ISM Manufacturing and ISM Non-Manufacturing have shown signs of recovery. The June manufacturing reading rose to 52.6 from a low of 41.5 in April, while the service reading rose to 57.1 from 41.8. It is important to note that while a reading above 50 indicates sector expansion, the information value may be diminished when businesses are building off a low base like the one seen in April. Various inflation measures remain visibly below the Fed's 2% target rate, giving the Fed ample room to supply stimulus with little worry over sparking inflation at this point. While analyst estimates point to robust growth in the second half of 2020, realizing a durable expansion is threatened by additional rounds of economic shutdowns as the number of positive COVID-19 tests rise in various parts of the country.

Monetary Policy – The Fed has continued to provide broad support for the smooth functioning of financial markets through low rates, asset purchases and targeted credit facilities. The Fed's policy reaction function appears to be asymmetric, with economic and / or financial market declines met with a vigorous policy response while asset price appreciation and strong growth are allowed to run.

Broad Fed Policy Initiatives

Policy Rates – The Fed has indicated the current federal funds target range of 0.0% – 0.25% will remain in place at least through 2022.

Asset Purchases – The Fed has committed to monthly net purchases of $80 billion in U.S. Treasury Securities and $40 billion in agency and agency mortgage-backed securities. "Securities Held Outright" on Fed's balance sheet grew $1.326 trillion in the quarter (from $4,800.9 trillion on April 1st to $6,126.9 trillion on July 1st).

Targeted Credit Facilities – As of July 1st, the Fed had committed $12.799 billion to the Commercial Paper Funding Facility, $41.940 billion to Corporate Credit Facilities, $37.502 billion to the Main Street Lending Program and $16.081 to the Municipal Liquidity facility.

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The Fed has been far more proactive implementing policy initiatives than during the Great Financial Crisis, when perceptions of Wall Street malfeasance presented moral hazard questions around monetary and fiscal responses.

Fiscal Policy – The primary fiscal response to the economic slowdown crisis was the CARES Act, which was passed into law on March 27th. CARES provided $260 billion in expanded unemployment benefits, including $600 per week in additional benefits which are set to expire on July 31st. The expanded benefits were meant to bridge the decline in employment compensation as the Unemployment Rate soared into the teens, and in some cases, analysts estimate the replacement value at well over 100% of previous wages. Government transfer payments have allowed many consumers to remain current on mortgage and other debt payments and bolster savings levels at the same time, which has in turn supported bank loan and securitized debt credit quality. There appears to be bipartisan support for another round of fiscal stimulus as the July 31st cliff approaches.

Credit Markets – A rapid decline in U.S. Treasury yields, dramatically wider credit spreads and illiquidity dominated the credit markets in March. Positive price performance from lower U.S. Treasury yields was more than offset by the negative price impact of wider spreads, particularly for lower-quality issuers and indexes. The damage to risk assets was reflected in equity levels where, peak-to-trough, the S&P 500 and NASDAQ declined 34.0% and 30.1% respectively. After reaching $14.9 trillion in market value on March 9th, the Barclays Global Aggregate Negative Yielding Debt index ended the quarter at $10.6 trillion. Unlike previous periods where the decline was driven by improving global growth prospects, March's decline was driven by increased credit concerns. One bright spot for credit conditions was the robust primary market for investment-grade debt, which set records for monthly and quarterly issuance. A significant portion of new issuance was focused on debt with tenors of 10 years and longer, which was met with strong demand from pensions and life insurance companies in need of both duration and yield.

Yield Curve Shift

U.S. Treasury Curve	Yield Curve 03/31/2020	Yield Curve 06/30/2020	Change (bps)*
3 Month	0.061%	0.129%	6.8
1 Year	0.155%	0.150%	-0.5
2 Year	0.246%	0.149%	-9.7
3 Year	0.293%	0.173%	-12.0
5 Year	0.380%	0.288%	-9.2
10 Year	0.669%	0.656%	-1.3

The 3-month to 10-year portion of the yield curve flattened by 8.1 basis points (bps), driven primarily from a small recovery in 3-month T-Bill yields after severe downward pressure on short-term rates in late March. Given the enormous amount of Fed intervention into the U.S. Treasury curve, the information value of a flatter / steeper yield curve has diminished.

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Duration Relative Performance

**Duration estimate is as of 6/30/2020*

U.S. Treasury indexes basically earned its coupon rate in the quarter with minimal room for additional price appreciation return from lower yields. Each of the ICE BofA U.S. Treasury Indexes listed saw quarter-end duration levels rise from the end of the first quarter, as the massive net issuance of Treasuries in the second quarter tended to be longer than the average duration of securities previously held in the benchmark.

Credit Spread Changes

ICE BofA Index	OAS* (bps) 3/31/2020	OAS* (bps) 6/30/2020	Change (bps)
1-3 Year U.S. Agency Index	37	20	-17
1-3 Year AAA U.S. Corporate and Yankees	43	16	-27
1-3 Year AA U.S. Corporate and Yankees	153	39	-114
1-3 Year A U.S. Corporate and Yankees	221	63	-158
1-3 Year BBB U.S. Corporate and Yankees	426	142	-284
0-3 Year AAA U.S. Fixed-Rate ABS	256	59	-197
*OAS = Option-Adjusted Spread			

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.

Corporate credit spreads recovered a significant portion of the widening seen in the second quarter. The primary driver for credit's strong second-half performance was the Fed's decisive actions to support and liquify the credit markets, including quantitative easing and the direct purchase of corporate debt and investment-grade ETFs. OAS spreads remain wider than December 31, 2019 levels, which is reasonable given the uncertain outlook for the economy and credit markets.

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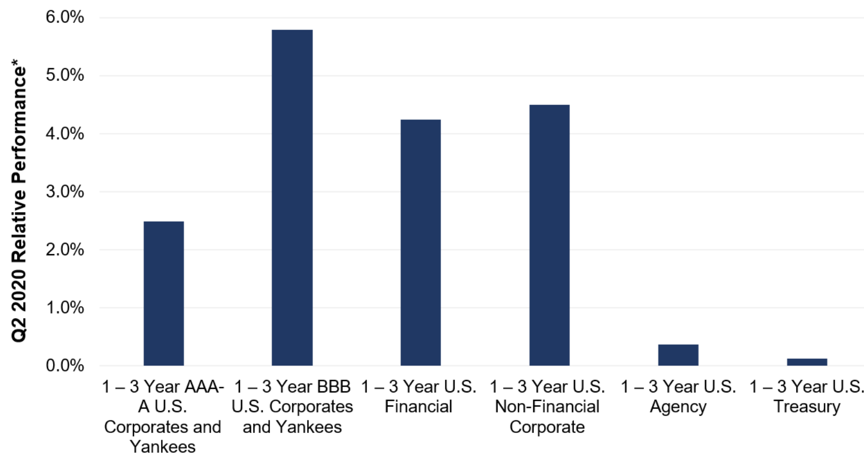
Credit Sector Relative Performance of ICE BofA Indexes



**AAA-A Corporate index outperformed the Treasury index by 235.5 bps in the quarter.*

AAA-A Corporate index underperformed the BBB Corporate index by 329.8 bps in the quarter.

U.S. Financials underperformed U.S. Non-Financials by 24.9 bps in the quarter.

Given the Fed's strong support for the credit markets and a decidedly risk-on attitude of investors in the second quarter, lower-rated corporate credit handily outperformed their higher-rated counterparts. Non-financials outperformed financials by 24.9 bps and industrial companies took advantage of robust primary market conditions to issue longer-term debt to build cash balances, pay down bank lines, refinance commercial paper and pre-fund upcoming debt maturities.

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

The second quarter of 2020 was a continuation of the first as the invasion of COVID-19 forced market participants to speculate on the timing of potential recovery scenarios as volatile economic data was delivered. As far as investors were concerned, it was made clear by the Fed that no matter how the economic recovery evolves, policy will be easy and rates will remain at or near zero for the foreseeable future. The money market industry continued to see inflows as the second quarter began, but as funds yields declined and the panic subsided, fund balances began to decline. U.S. Treasury bill and Repo levels came off March levels - of near-zero - as government stimulus injected significant bill supply into the market,. The increased Treasury and Repo levels gave funds a modest yield boost heading into another zero-rate era.

First American Prime Obligations Funds
The volatility for prime money market continued to dissipate in the second quarter, as the Fed's liquidity programs (MMLF, CPFF, PDCF, etc.) restored confidence in front-end liquidity while stabilizing prime fund metrics. Facing a very uncertain economic backdrop, we positioned the funds with high-quality credits supporting strong liquidity metrics based on shareholder makeup. We diligently reviewed and monitored each of our underlying credits, maintaining positions that presented minimal credit risk to the funds and its investors. Under the current market conditions, our main goal was to maintain liquidity and judiciously enhance portfolio yield based on our economic, investor cash flow, credit and interest rate outlook. We believe relative fund yields will remain elevated, making the sector an attractive short-term cash option for investors.

First American Government and Treasury Funds
As the quarter began, Treasury and government funds continued to see significant inflows as a flight to quality and yield remained prevalent. The increased treasury supply, stemming from government stimulus, resulted in higher repo and T-bill

yields to fund investors. Management continued to focus on securing long-term yield when it could, anticipating a low yield environment for the foreseeable future. Throughout the quarter we found opportunities in both fixed- and floating-rate investments that we believed made economic sense and felt would benefit shareholders and add value over the life of the security.

First American Retail Tax Free Obligations Fund
The swift recovery in financial markets and improved liquidity led us to consider some changes to strategy during the quarter. Fund management centered on building higher fixed-rate allocations, with a desire to lock in purchase yields for 3-12 months. We were active with extension trades throughout the quarter, but most specifically during April when the best values were attainable. Given COVID-related deterioration in credit fundamentals for many fixed-income sectors, we focused intently on security selection. Only issuers with strong balance sheets, reserves and financial flexibility were considered acceptable.

What near-term considerations will affect fund management?

In the coming quarters, we anticipate yields will stay low as the U.S. progresses through the COVID-19 pandemic, upcoming recession and the Fed's easy monetary policies. We anticipate the yield on non-government debt has bottomed as a result of Fed liquidity programs, tightening LIBOR levels and improved liquidity in this space. Prime money fund yields will decline as seasoned pre-pandemic purchases mature, but we believe both the institutional and retail prime obligations funds will remain attractive short-term investment options for investors seeking higher yields on cash positions while assuming minimal credit risk.

Yields in the Government-Sponsored Enterprise and Treasury space will remain influenced by Fed policy and Treasury bill / note supply. We believe the Fed will continue to provide the tools necessary to normalize the repo market, provide market liquidity and control front-end rates. Assuming no additional fed policy adjustments, we anticipate T-bill issuance to remain robust, providing the sector with an outlet for the large balances. The large amount of Treasury issuance may create some yield volatility on the short end as the supply gets absorbed. We will continue to seek opportunities – in all asset classes – that arise from market volatility based on domestic and global economic market data as well as changes in our Fed rate expectations.

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

Sources

Bloomberg

Federal Reserve

U.S. Department of Treasury

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.
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 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.
Government-Sponsored Enterprise (GSE) is a quasi-governmental entity established to enhance the flow of credit to specific sectors of the American economy. Created by acts of Congress, these agencies, through privately held, provide public financial services. GSEs help to facilitate borrowing for all sorts of individuals, from students to farmers to homeowners.
ICE BofA 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 BofA 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 BofA 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 BofA 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 BofA 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 BofA 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 BofA 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 BofA 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 BofA 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 BofA 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 BofA 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 BofA 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 BofA 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 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 index is a key measure of the national economy.
ISM Non-Manufacturing 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.
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.
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.
NASDAQ is a global electronic marketplace for buying and selling securities, as well as the benchmark index for U.S. technology stocks.
S&P 500 is a stock market index that measures the stock performance of 500 large companies listed on stock exchanges in the United States.
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.
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.

[See next page for important disclosure information]

The information and views expressed are provided by the funds' portfolio manager(s) and are current only through the date on this report. They are not intended to provide specific advice or to be construed as an offering of securities or a recommendation to invest. One cannot invest directly in an index. This information is subject to change at any time based on upon market or other conditions and may not be relied on as a forecast of future events or a guarantee of future results. Fund holdings, sector and portfolio allocations are subject to change at any time and are not recommendations to buy or sell any security. **Past performance does not guarantee future results.**

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For U.S. Treasury, Treasury Obligations and Government Obligations – *You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.*

For Retail Prime Obligations and Retail Tax-Free Obligations – *You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. The Fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.*

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Income from tax-exempt funds may be subject to state and local taxes and a portion of income may be subject to the federal and/or state alternative minimum tax for certain investors. Federal income tax rules will apply to any capital gains distribution.

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