

# TENTMAKERS

Financial Counsel for Pastors, Deacons, and Seminarians

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## MONEY-MARKET FUNDS

by Gary North

A revolution in monetary affairs has taken place since 1978. More and more Americans have discovered what has happened, but the vast majority of Americans are still ignorant, and it is costing them billions of dollars annually. There is no reason why your church's members should remain ignorant any longer.

The development of the money-market fund has come almost overnight. Almost \$150 billion are now invested in these funds. People can get as high as 17% on their invested dollar, with very high safety. The funds generally offer check-writing privileges (usually with a minimum figure for the check of \$500), and they will transfer money to your bank on request by bank wire. Many of them have toll-free (800) telephone numbers. Thus, the saver receives very high returns on his Invested dollar, with total liquidity. He can get his money out fast, if he needs to.

The banks and thrift institutions are understandably upset by this development. The best that they can offer the small investor is a 30-month certificate that pays a high rate of interest, but which cannot be drawn out on demand without suffering a penalty. So the banks offer low liquidity, with interest rates no higher than what is available from a money-market fund. Some of these bank-sponsored investments are misleadingly called "money market certificates," but nothing is a true money-market investment if there is any restriction on withdrawing money on demand.

Why is it that banks and savings and loan associations are not competitive? Government regulation is the predictable answer. The standard passbook account is limited by law to under 6% per annum. This means that to offer liquidity, the banks cannot offer a market rate of return. This is the infamous Regulation Q, and it has disrupted the whole banking industry, as any price control (ceiling, in this case) always will. It reduces the flow of savings into the banks and thrift institutions.

Smart investors do not keep more than minimal balances in a local bank. These people, however, are limited in number. Most Americans are too cautious, or too ignorant, or too lazy to do something to protect themselves from inflation. The average deposit by a household in a money-market fund is \$18,000 (as of late summer, 1981). Not that many families have net liquid assets of \$18,000 to deposit anywhere. This indicates that the average investor is out of this market, despite the fact that many money-market funds only require \$1,000 to get started, and one has no minimum balance. (A few areas high as \$10,000.)

### What Are They?

How do such funds exist? Where do they put their money? The answer is that they put their money in the same investments that banks put their "jumbo CD's," or certificates of deposit. A short-term certificate of deposit, sold by banks in units of \$100,000 or more, is not under the restriction of Regulation Q. In short, the government allows banks and S&L's to pay market rates of return to rich people. The bank then invests in short-term debt

certificates of major American corporations or government debt certificates, such as U.S. Treasury bills. These pay a rate of return for perhaps three months, or even 30 days. The interest rate on the CD is fixed for six months or whatever. The interest rate for a money-market fund varies with the return of the whole portfolio of the fund. The safer the investment, the lower the rate. For example, Capital Preservation Fund of Palo Alto, California, invests solely in short-term U.S. Treasury bills, the safest paper money investment. It was the first company to offer such a portfolio, although there are several imitators today. It pays a percent or two under the highest paying funds that put more of their assets into higher risk corporate notes. The funds are remarkably safe, in any case. But a T-bill fund is probably safest, if there were to be a total deflationary collapse of the economy.

The funds offer liquidity because there are well-developed markets for the debt certificates of the major corporations. If people start pulling money out of a particular fund, it can sell its assets without suffering a major loss. Only if all corporate debt certificates started going down at once would there be a problem. In such an instance, an investor could lose a portion of his capital. But these markets would start collapsing after a stock market crash, not before. The money-market's assets are short-term legal debt obligations of the issuing corporations. This is precisely the kind of investment people would want to buy in a crash. They would be more likely to buy such short-term debt rather than stocks or bonds if they were worried about solvency of American corporations. Corporations must pay off these obligations first. The law requires this. Also, by diversifying their portfolios, the money-market funds are in a position to offer the investor safety, since it is most unlikely that all the corporations of America would default on their debts overnight. You can get out.

The Interest rates prevailing in the late summer of 1981 are the highest in history. At 17%, the funds are paying almost 7% over the underlying rate of price inflation — a phenomenally high rate of return for a secure investment. If such rates were to continue, and price inflation stayed at 10%, it would mean that a person could double his money, almost risk-free, every ten years—a real rate of return, not an inflationary return. (Income taxes, of course, would get a chunk of it). This is one reason why it is very unlikely that such rates will prevail for a year. But they are always higher than what a saver can get in a regular passbook savings account.

The guru of the funds is a 6-foot-tall pixie named William Donoghue. His book, *The Complete Money Market Guide* (Harper & Row, 1981; \$12.95), belongs on the bookshelf of every church in America. If the diaconates in this country were doing their job, every church member in the nation would have most of his liquid funds in a money-market fund. The deacons would sit down with everyone to tell them how to get a better return on their money. It is a sign of the impotence of the diaconate today that they are so incredible ill-informed. The leadership of the church

ches refuses to lead. Their followers suffer accordingly. This should not be.

Donoghue writes a newsletter that discusses the fund industry. He also supplies data for major newspapers. *The Wall Street Journal* reprints his report every Friday. You can check it to see which funds are performing well, or not so well. It does not list all funds, however. There are over a hundred, and the number is growing.

#### Riding the Yield Curve

One way a moderately innovative investor can get a higher return on his money during periods of recession, when short-term interest rates start to drop, is to put his money into a money-market fund with its assets invested in longer-term maturities (say, three-year maturity dates). This way, the fund gets a guaranteed return on its money (meaning your money) – a return that has been “locked in” at the high rates that prevail in the wilder period (such as late summer, 1981).

Some firms offer short-term and long-term options. For example, Capital Preservation Fund has one fund's assets in short-term U.S. Treasury bills, with the other fund in longer-term U.S. government notes. You can switch to the longer-yield fund when you think that rates have peaked. (Busy number? Call collect: [415] 858-2400.)

Capital Preservation Fund I	Treasury Note Trust
755 Page Mill Rd.	755 Page Mill Rd.
Palo Alto, CA 94306	Palo Alto, CA 94306
(800) 227-8380	(800) 227-8380
\$1,000 minimum deposit	\$1,000 minimum deposit
\$500 per check minimum	no checks: bank wire
2-week maturity T-bills	18-month maturity T-notes

When interest rates hit bottom (you think), you can switch back to the shorter-maturity fund. Then, as the fund buys certificates that keep paying higher and higher rates, your investment return increases. It takes guesswork, but it can be done. Donoghue has data that help you make just such a decision in his bi-weekly *Moneyletter* (free sample on request: P. O. Box 411, Holliston, MA 01746). You can make significantly higher rates of return on your money if you guess correctly.

#### U.S. Savings Bonds

There is only one good reason for investing in these turkeys: masochism. They pay a miserable rate of return. They are not very liquid. You can't write checks on them. All in all, nobody in your congregation should own them. The deacons should warn people not to hold their savings money in them. If you want to lend the government your money, buy shares in a money-market fund that buys only high-yielding government debt. Get 15% or more on your money that the government uses, not 7%. Be patriotic at a decent rate of return, assuming that it's a matter of patriotism to buy government debt (and I don't assume that it is).

Older members may have a warm feeling about U.S. Savings Bonds. They may remember buying them when they were called war bonds. They still are a sort of war bond: war against the uninformed citizen's best interest. Make certain that anyone in your congregation who still owns E-bonds or other long-term government savings bonds reads this letter. Let him cash them in, pay any taxes, and start earning a decent rate of return. Inflation is eating these people up without adding government insult to government-created injury. People need to be warned.

#### Float

Many times, I have written rather large checks on my money-market fund in California. In my record book, I spent the money. However, I was still earning 15% or more on my money during the time the check was in the mail to my creditor, and also while it was in the mail from his bank to the bank used by my money-market fund. Yet you can wire money to your fund overnight. Thus, you start earning interest as soon as it arrives by bank wire transfer, and it continues to earn money until your checks finally clear the bank. I use a California-based fund, so that my checks written outside of California will take longer to clear. A California resident would want a Boston or New York money-market fund. After all, the banks use your money like this every day. Why not you, too? The money-market fund is using your money during the interim, so why not get your lion's share of the action? Somebody will use the money while checks are in the mail. Why not you?

#### Recession

These high interest rates will have their effect on the economy. When businessmen finally get scared about paying 20% on their borrowed funds, they will stop business expansion. Rates will drop, but only in response to falling demand. This means recession. At the beginning of a recession, people need liquidity. Cash can be used for buying up goods that are being sold at depressed prices: at auctions, flea markets, and garage sales. Keep money in a money-market fund until you need it. Then a phone call gets it wired to your local bank. Once your bank has it, you can withdraw cash, or keep it in your NOW-checking account locally. (A NOW-account pays interest on checking.) The bargains will be available when the economy slows down. Be patient. Cash will be king again, if only for a couple of years. I think that 1982 should be a year for excellent buying opportunities. In the meantime, get the highest rate you can “on” your savings, with sufficient liquidity. This means a money-market fund. Do not tie up your money for 30 months. You don't need to. You can get high rates without locking yourself in. Christians must invest more intelligently.

#### Selected Funds

In addition to the two Capital Preservation Fund versions listed earlier, you can consider these. Call or write to receive a prospectus (legal requirement).

Alliance Capital Reserves	NEL Cash Management
140 Broadway	500 Boylston St.
New York, NY 10005	Boston, MA 02117
(800) 221-5672 (toll-free)	(800) 225-7670 (toll-free)
no minimum deposit	\$1,000 minimum deposit
\$500 per check minimum	\$250 per check minimum

A list of the various funds is available in the back of Donoghue's book, although phone numbers and minimum deposit requirements change all the time. Small savers want small minimum deposits, naturally. Alliance Capital Reserves is unique in its no minimum deposit policy. It is a “widows and orphans” fund. Also a pastors' fund.

Obviously, if the church has extra money lying around, here is where it should be. There is no reason why the Lord's money should be earning 5% instead of a market rate of return. Let the talents multiply, but while you're waiting, get a decent interest rate (Matt. 25:27).