

Money Market Securities



Money market securities mature in a year or less. They are generally considered almost a form of cash as they are very liquid and very secure. That is not to say there is no risk, but generally speaking they are a cash equivalent. The market is made up of very large players and we participate through funds we get into through our brokers. The market is made up of debt securities issued by corporations and governments that need short-term funds. The instruments include Treasury Bills, Commercial paper, Negotiable certificates of deposits, Repurchase agreements, Federal funds, and Banker's acceptances.

Treasury securities are back by the “full faith and credit of the US Government.” This means in essence that they are “guaranteed.” But it is wise to recognize they are only as good as our government and its position in the world. Another way to look at this is the events that would cause our Government to default on the debt would be so catastrophic any worries about loss of principal that is invested in treasuries would be moot. But having no credit risk, doesn't mean they don't have risk. There is certainly the risk of interest rate changes and inflation losses. The interest rates could rise after a purchase causing the selling price to be lower than what was originally paid. Also, holding long term bonds at relatively low rates of return provides for the potential of not keeping up with inflation.

The text does a nice job of covering the bases with the rest of the instruments but I would like you to get a better feel for the market in general. In discussion questions is a file of a book excerpt of just a couple of pages outlining the money market and its peculiarities. I think it's a great read and one that you will enjoy even though it takes a little while to download.

The Bond Market



The bond market is where all types of bonds are traded and the price of bonds is set. As you all know this price moves inversely to interest rates so as the bond market rallies, interest rates are falling. If the bond market collapsed, it would mean that interest rates have jumped up. One way to understand this concept a little better is to view it from the eyes of the investor. The investor that is new to the market can buy either a new bond that is just being initially issued or an existing bond from another

investor. If the existing bond holder wants to sell, they have to sell at the market price because any attempt to gain an advantage will send the investor to the newly issued bond. Therefore all existing bonds if sold, provide the new owner the market rate of interest regardless of the coupon rate on the bond. So if the market rate is 10% and the bond was issued at 8% and then sold, it would sell at a discount because the coupon payment in the future would be less than the current level of a new bond. Conversely, if the market rate of interest was 8% and you want to sell a bond that pays 10% coupons, it will sell at a premium. I hope this is clear because it is a fundamental concept that really should be internalized.

There are many types of bonds that are sold. It may not be thought of as exciting as the stock market but there is lots and lots of money made and lost in bonds.

There are corporate bonds that provide loans to companies they use to finance various things including operations, R&D, etc. The interest rate is in part based on their credit rating with those that are less risky obviously paying less in interest. There are municipal securities are called Munies and are issued by state and local governments. There are several types and several risk associated with municipal bonds. Your text provides a solid overview of this sector of the financial markets. Obviously, one of the significant differences between Munies and Treasuries is the credit rating of the insurer. The federal government is considered to be just about “risk free” where as Munies have credit risk and ratings. There have been defaults in some Munies but they are rare.



Munies are sold originally in a primary market through investment or commercial banks and then can be resold in the secondary market. They provide tax savings to investors and no final value to a given investor can be determined without taking into account the tax savings.

Your text includes several other types of bonds. Also there are bond funds that need to be considered as they act similar to stock funds in that they try to buy the best performing bonds and allow small investors access to professional money management.

Almost every business needs access to credit at one time or another. Let me just add a bit to the text book. The commercial paper market is short term loans to credit worthy companies mainly for working capital and other near term needs. As the time frame extends beyond the near term, medium-term notes (MTN) can be used. Don't confuse MTN's with a short time frame as your text reveals that



Disney issued a 100 year MTN. The shelf registration of MTN's makes them an easy way to get financing when needed. Beyond that there are corporate bonds that can be issued.



One of the most interesting avenues is the lease. This may involve more parties than just the lessee and lessor. In fact, when United Airlines started having problems one of the fallout issues that came from that is that the leases on some of the aircraft were held in part by Disney. This means that Disney had a potential problem if United failed to make lease payments and they had to disclose that in their filings. This caught my attention as there must be more than one or two Disney shareholders that were unaware that they were taking a risk in supplying funds for leases to other companies. I suspect many thought Disney was in the theme park and TV businesses. But they found that the mouse was getting into just about everything.

One of the most interesting area's of corporate bonds involves a technique called leveraged buyouts (LBO's). The text mentions RJR Nabisco's LBO in 1988. There was a movie made about this one starting James Garner called "Barbarians at the Gate." I don't know if it gets two thumbs up but it is a sort of fun look at LBO's and how crazy they might get. The real lesson here is that although you might be able to borrow more money, the more you borrow, the more risky you become and the higher the rate. RJR's credit rating dropped substantially after the takeover because of the massive amount of debt that was hovering over the company. They survived and prospered but the risk was real.

One last thing I would like to mention is the bankers acceptance. International commerce is filled with risks that can be handled through vehicles such as this. Risk isn't eliminated but it can be managed for both companies using this to facilitate international trade.

This should be a good week as we live the fed behind and move toward other markets.