CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

DEBT LINE

Off Prints

California Debt And Investment Advisory Commission

Philip Angelides, Chair

Volume 20, No. 10 October 2001

INTRODUCTION OF THE 4-WEEK TREASURY BILL

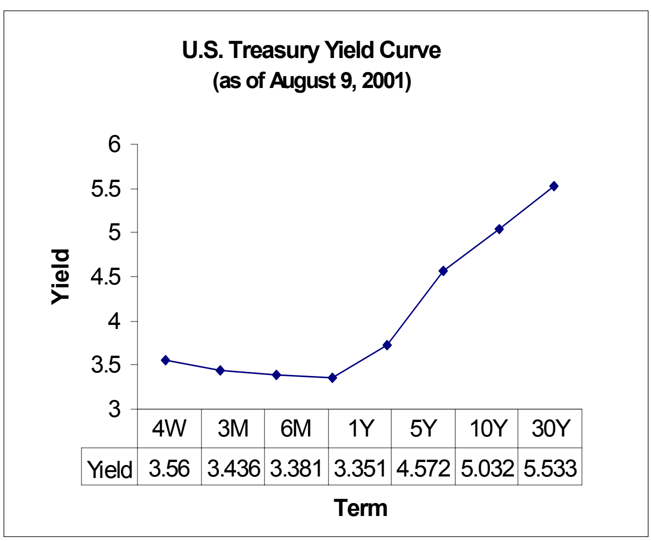
Frank Moore
CDIAC Policy Research Unit

The Department of the Treasury held its first auction of 4-week bills on July 31. Approximately $10 billion of these new denomination bills, with an issue date of August 2, 2001, were sold at a discount rate of 3.59%. This article looks at the viability of this new investment tool given the alternatives available to the public fund investor.

4-Week Bill

The Treasury originally announced the new investment instrument in May, but only recently finalized the program. It is anticipated that these 4-week bills will replace the sporadically issued 45-day cash management bills and will help the Treasury by smoothing seasonal fluctuations in its cash balances, reducing the reliance upon cash management bills, and improving the cost-efficiency of the Treasury's short-term financing.

The discount rate for the August 9 issue of the 4-week Treasury bill is plotted against other maturities in the graph below to derive a yield curve:



The short end of the yield curve illustrates an "inversion" from the upward slope that would be expected under normal circumstances. Yield inversions generally reflect investors' expectations of lower long-term rates in the future. Investors may feel that economic conditions are leaning towards a recession that will force long-term rates lower. As credit conditions tighten, short-term rates will creep up. While this situation is temporary, it does provide investors with greater opportunities for higher returns at the short end of the market.

Implications for Public Fund Investor

The addition of 4-week Treasury bills adds another investment tool to the repertoire of the public fund investor. This instrument should be of comparable credit risk with other Treasury bills. But there exist other safe, liquid, and equal yielding alternatives, such as the Local Agency Investment Fund (LAIF), agency discount notes, and commercial paper, that may be more appropriate investments. The following chart lists some of these instruments, with their yields, benefits, and drawbacks.

Short-term Investment Tools
as of August 9, 2001

Instrument	Money Market Yield [1]	Benefits	Drawbacks
Agency Discount Notes	3.581	Safety - some are tax exempt, yields typically higher than for Treasuries though less liquid	No significant disadvantages
Banker's Acceptances	3.56	Higher yield	Reduced liquidity, 40% cap on amount of portfolio
Certificates of Deposit	3.56-3.60	Safety - guaranteed by FDIC (if under $100,000)	Illiquidity - penalties for early withdrawal, though Negotiable CDs can be sold on the secondary market
Commercial Paper - Financial	3.61	Higher yield	Credit risk, 40% cap on amount of portfolio for counties (15-30% for non-counties) , reduced liquidity
Local Agency Investment Fund (LAIF)	4.55 [2]	Highest yield, highly liquid	$30 M cap on amount of portfolio
Repurchase Agreements (1-month GNMA)	3.507	Flexibility and market rates	Large amount of paperwork, large amounts of money needed
4-Week Treasury Bill	3.56	Safety - backed by full faith and credit of the U.S. Treasury, tax exempt interest, highly liquid	Low relative yield

[1] These are average yields for all instruments in this category
[2] Bond equivalent daily rate
Yield Source: Bloomberg and LAIF

CDIAC polled several investment advisors and asked whether they are going to use this new tool in their portfolio management process. The responses were mixed. For example, one investment advisor indicated a preference for LAIF, commercial paper, and agency discount notes (all of which they believe are equally safe and liquid but have higher yields) over the 4-week Treasury bill for short-term investments. Another investment advisor believes that this new tool has tapped an under-utilized segment of the Treasury yield curve. He sees the 4-week Treasury bill competing with agency discount notes, commercial paper, and repurchase agreements in terms of liquidity and yield. The instrument would be attractive to smaller and mid-sized municipalities for the investment of short-term money because they lack the sophistication needed for the credit analysis of commercial paper and the large amounts of money needed for repurchase agreements.

Conclusion

Given the current yield spreads, 4-week Treasury bills may provide an additional investment alternative for public agencies investing short-term money. For more information on the 4-week Treasury bill, public agencies should visit the U.S. Treasury, Bureau of Public Debt web site at **www.publicdebt.treas.gov**.

This Offprint was previously published in DEBT LINE, a monthly publication of the California Debt and Investment Advisory Commission (CDIAC). CDIAC was created in 1981 to provide information, education, and technical assistance on public debt and investment to state and local public officials and public finance officers. DEBT LINE serves as a vehicle to reach CDIAC's constituents, providing news and information pertaining to the California municipal finance market. In addition to topical articles, DEBT LINE contains a listing of the proposed and final sales of public debt provided to CDIAC pursuant to Section 8855(g) of the California Government Code. Questions concerning the Commission should be directed to CDIAC at (916) 653-3269 or, by e-mail, at cdiac@treasurer.ca.gov. For a full listing of CDIAC publications, please visit our website at http://www.treasurer.ca.gov/stocda.htm.