

## The Effects of the New Normal Environment on Cash and Short Duration Investing



### Jerome Schneider

Executive Vice President  
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Mr. Schneider is an executive vice president in the Newport Beach office and deputy head of the money market and funding desk. Prior to joining PIMCO in 2008, Mr. Schneider was a senior managing director with Bear Stearns.

He specialized in credit and mortgage-related funding transactions and was instrumental in the development of one of the first "repo" financing companies. He has 14 years of investment experience and holds an undergraduate degree from the University of Pennsylvania and an MBA from the Stern School of Business at New York University.



### Paul Reisz, CFA

Senior Vice President  
Product Manager

Mr. Reisz is a senior vice president in the Newport Beach office and a product manager covering the spectrum of Money Market, Enhanced Cash, Stable Value, and Income strategies. Prior to joining PIMCO in 2000, he was with

Transamerica Asset Management for more than 10 years, responsible for business development, client servicing and product development. He has 25 years of investment experience and holds an undergraduate degree from the University of California, Berkeley and an MBA from the Marshall School of Business at the University of Southern California. He is also a certified public accountant.

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*The dramatic dislocations in the cash markets have made many investors concerned about their short-term liquidity needs and investment options. Jerome Schneider, deputy head of PIMCO's money market and funding desk, and Paul Reisz, money market and enhanced cash product manager, provide an overview of the broad implications of the New Normal environment for the cash markets. They also discuss the strategies and investment vehicles that PIMCO is using in an effort to add value to cash portfolios, including the firm's new short-duration exchange traded funds (ETF).*

### How is the global economy's transition into the New Normal affecting investing in the various cash markets?

**Schneider:** The severe shocks to the global economy, the markets, large institutions, government policies and individuals are all

leading the world on a journey of change that we feel is not likely to be reversed quickly. This journey will likely be volatile and will arrive at a destination that looks to be very different than the short-end investing environment we have been living in for the past 15 years. Global growth will likely remain subdued, unemployment may be high and the role of government will likely become much more evident.

We have already witnessed the impact of the beginning of this change in the short-term markets. Money market yields have been extremely low, and the helping hand of government was necessary to provide liquidity during the worst part of the crisis. In the New Normal, government stimulus looks to turn into an increase in government regulation, potentially keeping cash yields low. This is already evident in the expected changes in 2a-7 money market regulations suggested by the Investment Company Institute, the President's Working Group on Financial Markets, and the SEC that would have an impact on the Weighted Average Maturity, liquidity, and credit quality of money market funds. The exact role of money market funds and their intermediating role in the daily liquidity of the marketplace are still critical questions that will have to be addressed in the coming months.

For most cash investors of all calibers, whether retail or institutional, this new market environment has had a direct impact by reducing yields as the demand for liquidity has increased. With the federal funds rate close to zero, and likely to stay there for some time, in most cases holding cash in money market strategies is has yielded significantly less than available enhanced cash investment strategies.<sup>1</sup>

In addition, many investors continue to feel compelled to be extremely conservative with their investment decisions and to make sure they have access to the cash they need. Even though some investors see an oasis of liquidity ahead of their caravan, they want to make sure it's not simply a mirage. After the dramatic dislocation in the financial system a year

ago, it is natural to want extra liquidity, but there are opportunities to pick up additional yield potential by moving from money market strategies to short-term strategies.

Simply put, we feel the pickup in yield potential from “pure cash” to “enhanced cash” investments is very attractive. Investors should look at their “pure cash” allocation to determine how much of it they really need in the near term to trade exactly “at the buck” every hour of every day, or whether in some allocations they can potentially tolerate very modest price fluctuations around par. By more closely examining the timing of your true cash needs, which your investment portfolio will need to satisfy, retail and institutional investors can look to put themselves in a position to capture the liquidity premium in the marketplace instead of paying it to the market.

#### How has the current situation affected cash investors?

**Reisz:** Until the crisis, many investors often relied on money market strategies for daily liquidity and principal preservation, and enhanced cash strategies for potentially higher yields with minimal NAV volatility. Since the crisis began there have been dramatic changes in the cash management universe, including the first major money market fund to “break the buck” that is, have their NAV fall below one dollar per share. As a result, we had a flight-to-quality, which when combined with a very low fed funds rate, has left many money market investors earning incredibly low yields.

Investors are looking for solutions and for a way to tailor cash management investment strategies to fit their risk tolerances and liquidity and principal preservation needs. Cash market investors today face a dilemma: If they require near-perfect principal preservation and liquidity, they must sacrifice yield.

#### How is PIMCO managing portfolios in light of all of the implications and market disruptions associated with the New Normal?

**Schneider:** In light of our secular, cyclical and credit outlooks, we believe that it is important to continue managing portfolios defensively, emphasizing liquidity and capital preservation rather than stretching for returns at the expense of incurring downside risk. Diversification across high-quality assets, including favored government, credit and mortgage assets, remains a keystone to our investment philosophy.

PIMCO also is emphasizing securities with income-producing potential in our portfolios. Low growth and political uncertainty favor high quality, yield-oriented securities over those offering mainly capital gains. With regard to credit risk, it makes sense to stay relatively high up in capital structures. We also continue to hold Agency mortgages, which have provided a relatively attractive source of high quality income. We are also diversifying portfolios with small allocations to municipal bonds, which also have provided an attractive relative value compared to Treasuries as well as strong credit quality.<sup>2</sup>

Even if investments are limited to high quality opportunities, we feel risk management, diversification, and conservatism are crucial components in managing cash portfolios in the current environment. Over the past two years we have seen the potential damage that overconfidence or unrealistic expectations can inflict on a portfolio when an investor tries to take on more risk exposure than is necessary, both from market-risk and operational perspectives.

In the New Normal market environment, a short duration strategy may provide a more attractive yield and return profile than a money market strategy, while still investing in defensive areas of the market. In other words, short duration strategies aim to provide safety, liquidity, and attractive yield potential.

#### How can cash investors account for the risks in the marketplace while also taking advantage of opportunities for enhanced yield on certain short-term securities?

**Reisz:** By looking at the different requirements they have, investors can invest their cash in multiple strategies that provide slightly different levels of liquidity and risk.

The first tier of cash market investment strategies offers daily liquidity and the strictest degree of capital preservation. This tier can be considered the assets used to pay for routine “grocery and utility bills.” We feel money market strategies (up to 90 days) are suitable here.

The second tier is suitable for “semi-permanent” or “non-immediate” cash allocations. This is what we would consider the emergency assets set aside for rainy days or for longer-term

expenditures rather than frequent, routine cash flows. A natural fit would be short-term (duration up to one year) cash strategies that emphasize liquidity and principal preservation and potential for enhanced returns.

## **PIMCO manages a variety of cash strategies, which now includes ETFs. How do these new ETFs address the needs and objectives of cash investors?**

**Reisz:** PIMCO's cash strategies are tailored to meet a range of objectives. Investors can allocate among different PIMCO strategies and vehicles, whether they are ETFs or mutual funds, in their efforts to better target their specific cash management objectives. Generally, cash investors are looking for safety and liquidity. Increasingly, these investors are also looking for greater transparency in their cash investments. PIMCO ETFs may help achieve these objectives.

First, PIMCO short duration ETFs provide investors with direct access to PIMCO's enhanced cash portfolio management skill set, including credit analysis and economic forecasting. Second, ETFs provide full portfolio transparency, an important consideration in the wake of the recent financial crisis. ETF investors can see what they own daily. Finally, ETFs are traded and priced throughout the day, providing intraday liquidity.

PIMCO's short duration ETFs may be an attractive alternative to money market strategies across a range of investment objectives. All three funds seek maximum current income, consistent with preservation of capital and daily liquidity. The funds vary in their investment guidelines, allowing investors to more precisely tailor desired potential for enhanced yield and return and required price stability.

Thank you, Jerome and Paul.

### **PIMCO Short Duration ETFs**

**PIMCO Enhanced Short Maturity Strategy Fund (Ticker: MINT)**, is intended to be a higher-yielding alternative to money market funds and may be appropriate for non-immediate cash allocations. MINT will primarily invest in investment grade debt securities rated Baa or higher by Moody's (or of comparable quality). The average portfolio duration of MINT will vary based on PIMCO's economic forecasts and active management process decisions, and will normally not exceed one year.

**PIMCO Government Limited Maturity Strategy Fund (Ticker: GOVY)**, is intended to be a higher-yielding alternative to government money market funds and may be appropriate for non-immediate cash allocations. GOVY will primarily invest in short duration U.S. government securities rated Aa or higher by Moody's (or of comparable quality) and maturing within two years from the date of purchase. The average portfolio duration of GOVY will vary based on PIMCO's economic forecasts and active management process decisions, and will normally not exceed one year.

**PIMCO Prime Limited Maturity Strategy Fund (Ticker: PPRM)**, is intended to be an ETF alternative to prime money market funds, with investment guidelines comparable to those of typical prime money market funds and may be appropriate for most cash allocations. PPRM will primarily invest in short duration debt securities rated A or higher by Moody's (or of comparable quality) and maturing within 397 days from the date of purchase. The average portfolio duration of PPRM will vary based on PIMCO's economic forecasts and active management process decisions, and will normally not exceed 90 days.

For more information, visit [www.pimcoetfs.com](http://www.pimcoetfs.com)

*Investors should consider the investment objectives, risks, charges and expenses of the funds carefully before investing. This and other information are contained in the fund's prospectus, which may be obtained by contacting your PIMCO representative. Please read the prospectus carefully before you invest or send money.*

<sup>1</sup> Source: Lipper

<sup>2</sup> Source: Barclays Capital

Shares of ETFs are not individually redeemable and shares may only be acquired from and redeemed by the fund in Creation Units. Investors may sell or purchase individual shares in secondary market transactions that do not involve the ETF. Shares of the Funds are bought and sold at market price (not NAV). Brokerage commissions will reduce returns. Please see the prospectus for more details.

**Past performance is not a guarantee or reliable indicator of future results.** An investment in an ETF involves risk, including the loss of principal. Investment return, price, yield, and NAV will fluctuate with changes in market conditions. Investment policies, management fees and other information can be found in the individual ETF's prospectus. Investing in the bond market is subject to certain risks including market, interest-rate, issuer, credit, and inflation risk; investments may be worth more or less than the original cost when redeemed. Certain U.S. Government securities are backed by the full faith of the government, obligations of U.S. Government agencies and authorities are supported by varying degrees but are generally not backed by the full faith of the U.S. Government; portfolios that invest in such securities are not guaranteed and will fluctuate in value. Corporate debt securities are subject to the risk of the issuer's inability to meet principal and interest payments on the obligation and may also be subject to price volatility due to factors such as interest rate sensitivity, market perception of the creditworthiness of the issuer and general market liquidity. Mortgage and asset-backed securities may be sensitive to changes in interest rates, subject to early repayment risk, and their value may fluctuate in response to the market's perception of issuer creditworthiness; while generally supported by some form of government or private guarantee there is no assurance that private guarantors will meet their obligations. Income from municipal bonds may be subject to state and local taxes and at times the alternative minimum tax; a strategy concentrating in a single or limited number of states is subject to greater risk of adverse economic conditions and regulatory changes. Derivatives may involve certain costs and risks such as liquidity, interest rate, market, credit, management and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested. Diversification does not ensure against loss.

The value of most bond funds and fixed income securities are impacted by changes in interest rates. Bonds and bond funds with longer durations tend to be more sensitive and more volatile than securities with shorter durations; bond prices generally fall as interest rates rise.

The credit quality of a particular security or group of securities does not ensure the stability or safety of the overall portfolio. The Average Credit Quality ratings are provided to indicate the credit worthiness of the underlying bonds in the portfolio and generally range from Aaa (highest) to B (lowest).

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