THE I/FAX

ADMINISTERED BY THE ILLINOIS STATE TREASURER DAN RUTHERFORD

Contact us at www.illinoisfunds.com or 1-800-346-7414 April 2011

MARKET PERSPECTIVE

By Mark Polistina

Overnight Rates Dip to near Zero, Again!!

As many of you have noticed the rate on the Illinois Funds has dropped to .02% or 2 basis points (bp). This is the result of repo levels falling from at or above 10 bp to 1 bp.

On 4/1 the FDIC began an assessment of all bank liabilities rather than the previous assessment only on insured deposits. (This increase is intended to fill the FDIC Insurance fund.) In essence this includes the excess reserves that banks hold at the Federal Reserve. The assessment is based on the bank's risk rating. Estimates are that this charge is between 15 and 25 bp. Given the disproportionate level of total liabilities to insured deposits in large institutions the fees will disproportionately come from them.

Currently, excess reserves are earning 25 bp at the Federal Reserve. Since the institution of the program to pay interest on excess deposits, banks would borrow cash in the market on an overnight basis and deposit the funds in excess reserves at the Fed, basically earning a risk free spread on the cash. Banks would borrow cash for example in the form of fed funds and repurchase agreements. Now with these excess reserves coming under the assessment of the FDIC, banks are in essence being taxed on them. The end result is an increase in the cost of borrowing. In order to compensate the other cost of borrowing must go down. In the markets this is shown in the yield given for the cash in fed funds at 5 bp, repo at 0 – 2 bp and lent collateral at 0 bp and in some cases negative.

During the depths of the recent financial crisis (Fall 2008) almost every major investment house opted to become insured banks/ bank holding companies. There are many reasons why this was needed; but; the primary reason in my opinion was to alleviate public fears associated with non-bank financial institutions and their presumed coercion in the crisis. The major investment banks now being traditional banks gain the benefits associated with them but they also take the bad.

These new very large banks are now subject to FDIC assessments. Because most every primary government securities dealer is now an insured bank the lending yield we receive on our cash has been reduced because of the new assessment.

Most everything being published at this time estimates that this will last at least 90 days. My fear is that this is wishful thinking. In order for this change one of the two foreseeable things must happen. 1) The Fed must start a tightening cycle (raise rates). 2) Increased issuance of short securities, primarily Treasury Bills, will need to increase. Both of these options do seem probable; but; not in the eminent future for many reasons.

1) (This will do nothing to change the spread; but; the baseline will increase above 0.) The Fed is still in the middle of QE2 which is in essence the direct opposite of tightening. The end is in sight for this program and to date no QE3 is in the works, however, the FED moves very slowly unless there is a crisis. In there eyes this is not a crisis.

2) (This could reduce the spread because of increased options for cash.) Treasury Bills are the short dated security that all others are measured against in the term of yields. At this point we have bumped up against the debt ceiling at the federal level and like the FED; congress is notoriously slow at moving unless there is a crisis. In the eyes of some, the level of federal debt is a crisis not lack there of.

The end result is we will see things change but I'm not expecting anything before fall.

Market Outlook

We anticipate the short term interest rate environment to remain bogged down in the current malaise with overnight levels below 5 basis points for some time. So our overall message will remain the same, take caution when extending maturities and look for those interim periods of higher interest rates.

Mark Polistina is the Portfolio Manager for the Illinois Funds.

Yesterday's Rate 4/7/11
Money Market Fund **0.043%**

Information in the Market Perspective was obtained from sources considered reliable. Their accuracy or completeness is not guaranteed. Opinions expressed are subject to change without notice.

Safety, Liquidity and Yield

Illinois Funds yields for the period ending 3/31/11

Money Market Fund (Daily Liquidity)

Net Portfolio Assets (in millions)	$5,643
Monthly Investment Earnings (in 1000's)	$394
7 Day Yield*	0.07%
One Month Yield*	0.09%
Net Asset Value (per share)	$1.00
Weighted Average Maturity	16
Weighted Average Life	16

*Yield Net of Fees

Monthly Public Sector Rate Comparison

The Illinois Funds, Money Market Fund			0.09%
S&P Govt Inv Pool-Govt Fund Index	0.09%	S&P Govt Inv Pool-Taxable Funds Index	0.13%
IL School Dist Liquid Asset	0.02%	IL School Dist Liquid Asset Max	0.08%
3 Month Treasury Bill	0.09%	6 Month Treasury Bill	0.15%

Monthly Private Sector Rate Comparison

The Illinois Funds, Money Market Fund			0.09%
IMoneynet™ - Govt. Institutional	0.01%	Federated Govt Obligations	0.01%
Fidelity - 695 Treas Fund	0.01%	Fidelity - 57 Govt Fund	0.02%
Goldman Fin Sq Treas Fund - 468	0.01%	Goldman Fin Sq Govt Fund - 465	0.04%
30 Day Time Deposit	0.11%	90 Day Time Deposit	0.36%

MONEY MARKET FUND COMPOSITION

50.5 % - Repurchase Agreements
6.8 % - Money Market Funds
0.4 % - Certificates of Deposit
30.9 % - Commercial Paper
11.4 % - US Government Agencies

E-Pay Account Rate

0.043% 4/7/11
1-866-831-5240
www.illinoisepay.com

Rapid Revenue Acct. Rate

0.043% 4/7/11
1-800-346-7414

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