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Market Facts

Asset-Backed Commercial Paper's Selloff

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An economist contributed some insights to an anthology of investing rules in 2001. Rule #4 of 12 read:

> ***Own the decision points.*** *Never structure a position so that someone else can force your exit. Every time you've written an option, either directly or embedded, you've surrendered control of your trade to someone without your best interests at heart.*

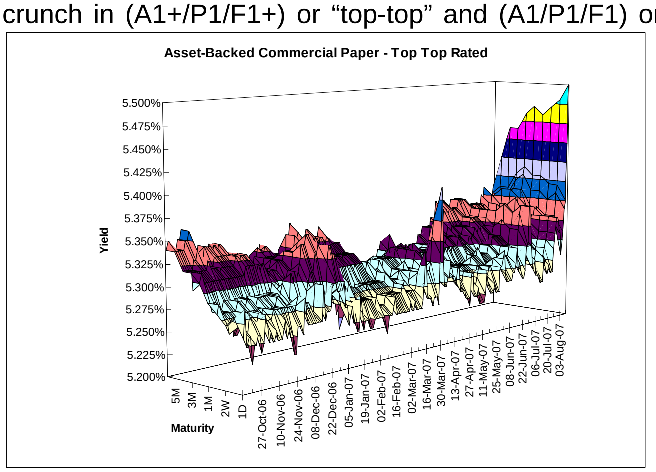
Rule #5 of 12 read:

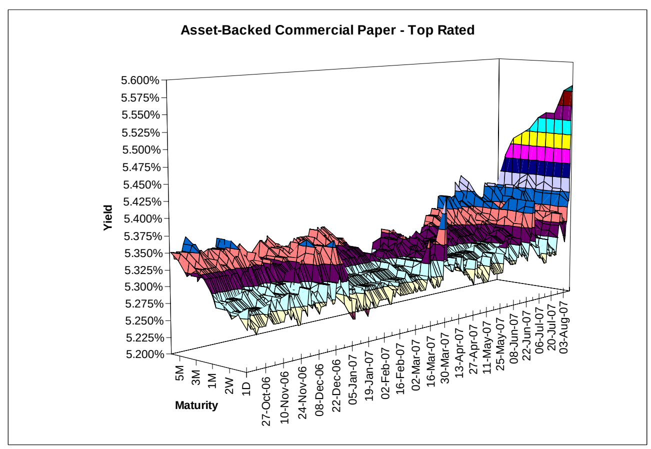
> ***Markets move further and faster than we ever believe.*** *Traders protect themselves against small setbacks and bet the large ones won't happen. That's why they do.*

These admonitions came to mind when news of a credit crunch in (A1+/P1/F1+) or "top-top" and (A1/P1/F1) or "top" asset-backed commercial paper came to light yesterday morning. Yields over the past ten months for top-top (left-hand chart) and top-rated (right-hand chart) commercial paper for overnight, 1, 2 and 3-week, and 1, 2, 3, 4, 5 and 6-month maturities are shown.

All data until yesterday were the noise of a short-term funding market. Yesterday, the move describable as "further and faster than we ever believe" began.

The most remarkable aspect of this sorry development is the biggest jump occurred at the very shortest maturities, the one-day and one-week. Money market funds and others who owned this seemingly safe paper found someone else owned the decision points. As is always the case, liquidity disappeared when its price was increased.





Conclusion

We concluded our most recent [Market Facts](#):

> *A reprise wherein the Federal Reserve announced a similar readiness would go a long way to stemming the present panic in the air over credit conditions. This "moral suasion" is a far more powerful weapon than the next 25 basis point move in rates.*

The Bank of Canada issued such a [statement](#) yesterday, and the Federal Reserve issued a similar [statement](#) this morning.

Panic is not a permanent state of affairs, and so it will pass. Fear of the unknown can endure until people are comfortable the situation is under control. Until these fears are addressed with facts, even the simplest instruments' decision points will lie in the hands of an impersonal market without your best interests at heart.

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