VANDERBILT Ave.
ASSET MANAGEMENT

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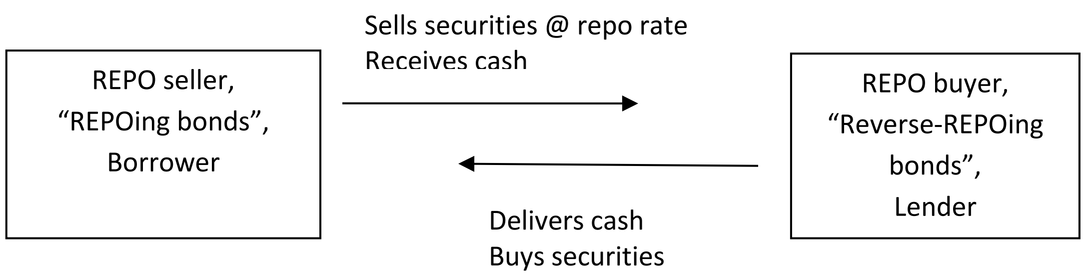
REPO or Reverse-REPO? ... Buying or Selling? … Depends Who's Asking

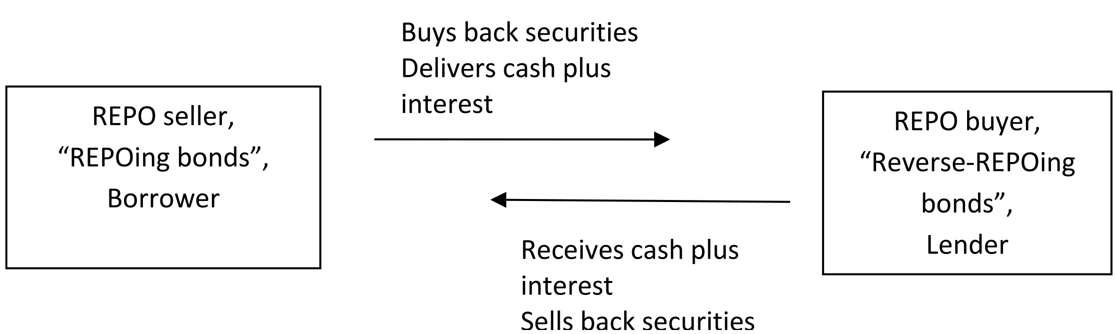
While the bond market offers something for everyone, at times there just isn't enough. For some institutions there isn't enough cash, while others seek more investments. The solution to these quandaries is entrance into a repurchase agreement ("REPO"). The REPO is a simple and useful investment tool, and those new to the REPO market will find that it is a secure way to borrow or lend money, once they get past all of the terminology. Let's begin.

A REPO is the sale of securities by one party to another party, combined with an agreement to purchase back those securities at a later date with interest. REPO agreements are typically short-term, sometimes maturing overnight. The REPO seller is the cash borrower and the REPO buyer is the cash provider. The REPO transaction is typically stated from the REPO seller's point of view. To the REPO buyer, also known as the lender, the transaction is referred to as a Reverse-REPO. (See diagram)

Upon entering REPO transaction:



Upon maturity of REPO transaction:



Reasons for entering into a REPO or Reverse-REPO vary by institution. For example, money market funds that are cash rich may choose to function as lenders by entering into Reverse-REPO transactions in order to enhance their returns. Conversely, securities dealers or hedge funds sometimes find themselves cash poor and need to REPO securities overnight to make up the difference until their cash position returns to neutral.

The REPO borrowing/lending interest rate depends upon several factors: the type of security being REPOed (U.S. Treasuries, U.S. Agencies, Agency MBS, or less commonly Corporate or Non-Agency MBS or Equities), the term of the REPO, the credit risk of the counterparty, and supply and demand for the securities being REPOed. Supply and demand actually play an integral part in setting the REPO rate, especially for securities that are in high demand, also known as "special". A borrower who REPOs a security that trades special usually pays a below market rate for the cash received. A bond may trade special in the REPO market when it becomes cheapest-to-deliver in the futures market and futures sellers, in order to avoid penalties to the futures clearing house, drive up demand by bidding aggressively in the REPO market.

In addition to the REPO rate, the Repo seller (borrower) must provide a "haircut", which is a form of over-collateralization for the cash borrowed. For example, an investor who needs to borrow $10MM may need to REPO securities with a market value of $10.5MM (i.e. 5% haircut). This provides the lender a sense of extra security.

The Federal Open Market Committee ("FOMC"), a branch of the Federal Reserve, also participates in REPO transactions to add or remove reserves from the banking system. The Federal Reserve would typically buy U.S. Treasuries, U.S. Agencies or MBS from a dealer for a short period of time, usually less than a week. This would be used as a monetary policy tool to adjust money supply and thus, stabilize interest rates.

REPOs in the news:

While the demand for REPOs is stronger than ever, recently the availability of REPOs has declined. This is attributable to the Fed's increased holdings of U.S. Treasuries, overseas demand for U.S. bonds versus lower yielding European bonds, and rules for banks to reduce holdings of trading securities. As a result, the market is operating with a shortage of REPOable securities. One of the casualties to this shortage has been Money Market funds, who struggle to invest cash in short safe assets. And naturally, as supply/demand fundamentals would have it, when REPO transactions are warranted, interest rates for REPOs on some securities that trade on special have plummeted, even to levels below zero. This occurs when institutions need to have access to certain securities, whether to cover a short position or to hold high quality assets for liquidity, and they are lending their money at rates so low or even negative, and effectively paying another institution to borrow their money.

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Emad is the Managing Partner and Chief Executive Officer of Vanderbilt Avenue Asset Management LLC. Vanderbilt's client base includes Multi-national Corporations, Public Funds, Foundations/Endowments, and Taft Hartley accounts.

Previously, Emad was Chairman of Institutional Business at Pioneer Investments. Pioneer investments has more than $300 Billion in assets under management. The parent of Pioneer, UniCredit S.p.A., is the largest bank in Italy and the second largest bank in Europe. Pioneer had purchased Vanderbilt Capital Advisors, of which Emad was the founder and Chief Executive Officer.

Emad has had numerous articles published in professional and academic journals such as The Journal of Forecasting, The American Economist and The Journal of Fixed Income. He is a Board member of The National Investment Company. Emad was a member of the Board of Advisors of the Pacific Institute, The Advisory Committee of Fulcrum Global Partners, The Chief Executive Officers Club and formerly a board member of The Foreign Policy Association. He also served on the Board of Directors of the University of Albany Foundation, NextGen Healthcare Inc., The Park Avenue Bank, AA Bank and The New Providence Fund and Associates LP.

Emad is an FINRA Arbitrator. He is also a member of the National Association for Business Economists and The Economic Club of New York. Emad served as an adjunct professor at the University of Kansas and St. John's University.

Emad holds a Bachelor of Science from the University of Albany, and a M.A. and Ph.D. in Economics from the University of Kansas.