Invesco

Beyond money markets: Maximizing cash

Trending Conversations

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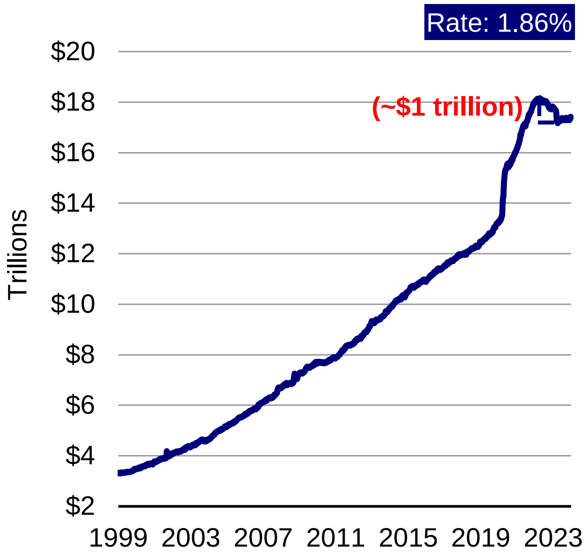
Money market assets are at all-time highs

Influx into money markets

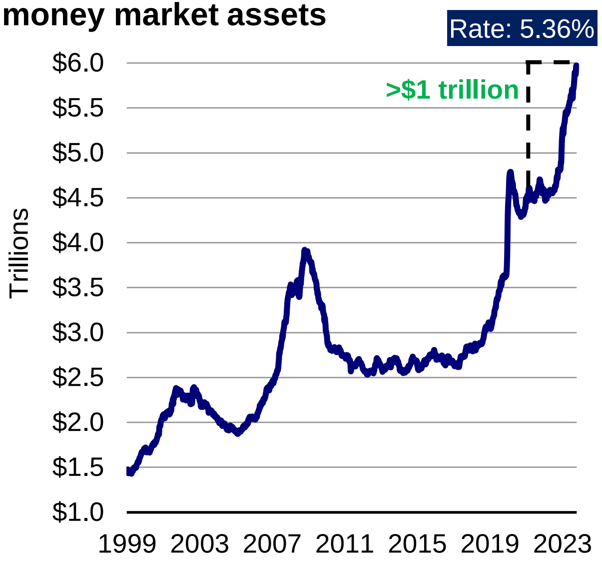
Investors have been moving money out of lower yielding bank deposits in search of attractive income and relative safety. Money markets are among the primary beneficiaries, which isn't surprising since they're yielding roughly 5%, or more.

Money markets, however, may not be the best strategy for investors over the coming years. In this presentation, we'll show how history has shown that investors may be better off locking in yields with longer-term securities versus exposing themselves to the reinvestment risk that's inherent in shorter-term securities.

US commercial bank deposits



Investment Company Institute money market assets



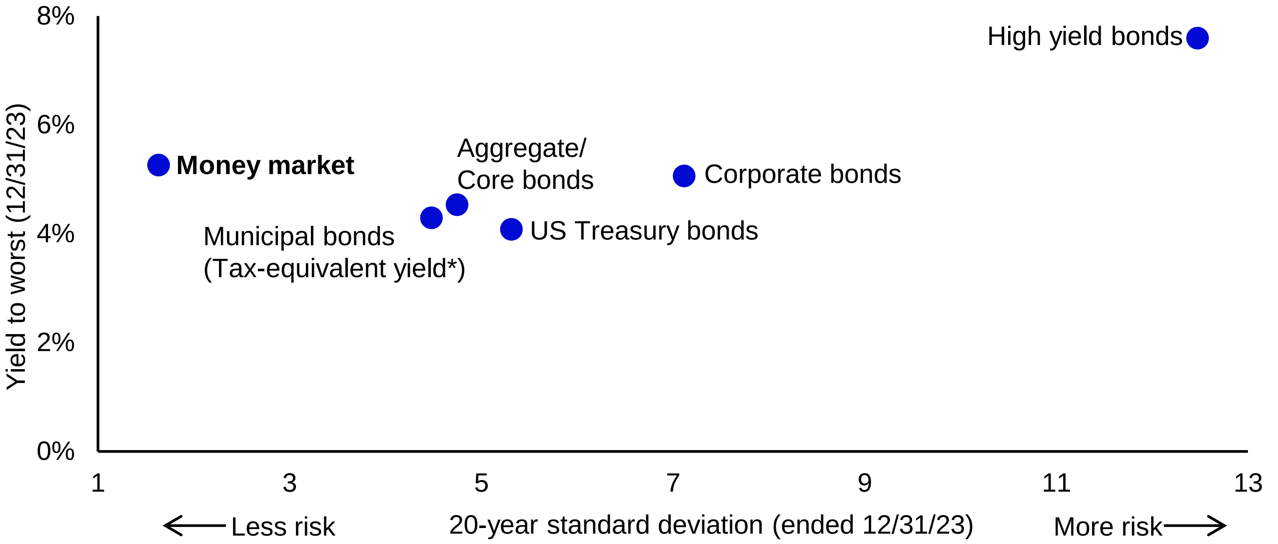
Sources: US Federal Reserve and Investment Company Institute, 1/17/24. Deposit and money market rates are based on the Federal Deposit Insurance Corporation 12-month National Certificate of Deposit rate and Bloomberg 1-3 month US Treasury Index.

Current money market appeal is obvious

Money market yields have been competitive with other high quality fixed income investments and have less historical volatility.

It may seem like a “no-brainer” for investors to take advantage of money market current yields, but there’s more to the story.

Yield and historical volatility of select fixed income asset classes



Sources: Bloomberg L.P., 12/31/23. Money market is based on the Bloomberg 1-3 Month US Treasury rate. US Treasury bonds are represented by the Bloomberg US Treasury Index. Core bonds are represented by the Bloomberg US Aggregate Bond Index. Corporate bonds are represented by the Bloomberg US Corporate Bond Index. Municipal bonds are represented by the Bloomberg US Municipal Index. *TEY=tax-equivalent yield based on a 25% tax bracket. High yield bonds are represented by the Bloomberg US Corporate High Yield Bond Index. Yield to worst is the lowest potential yield an investor can receive on a bond without the issuer defaulting. Standard deviation is calculated using rolling quarterly 1-year returns going back 20 years. An investment cannot be made directly into an index. **Past performance does not guarantee future results.**

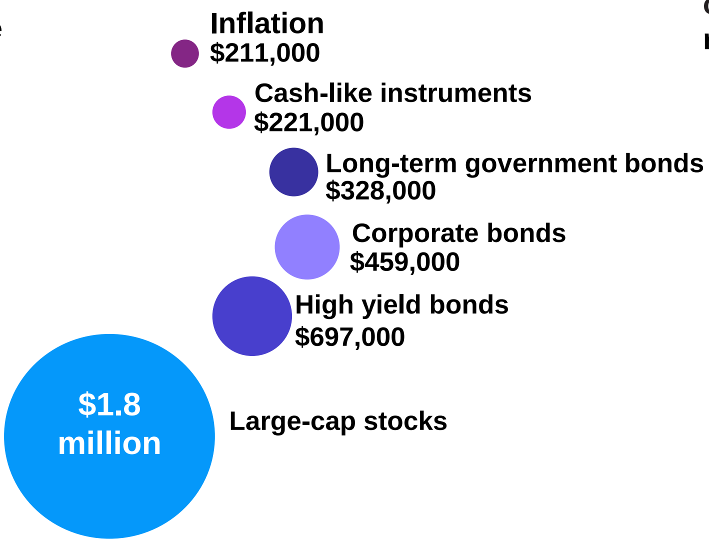
The risks of holding too much cash

Opportunity cost:
Short-term strategies tended to underperform over long periods of time

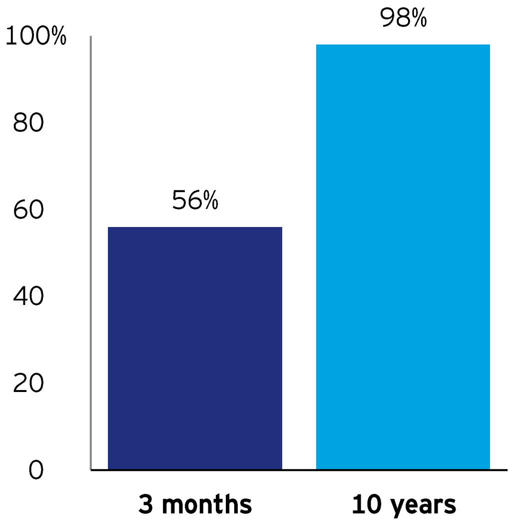
Cash-like instruments have historically generated significantly lower return than longer-term government bonds, corporate bonds, and equities.

While cash-like instruments may outperform Treasuries over short time periods, they rarely did during any rolling 10-year period during the past 30 years.

Growth of $100,000 (1993-2023)



Percent of time US Treasury bonds outperformed cash-like instruments for rolling monthly periods (1993-2023)



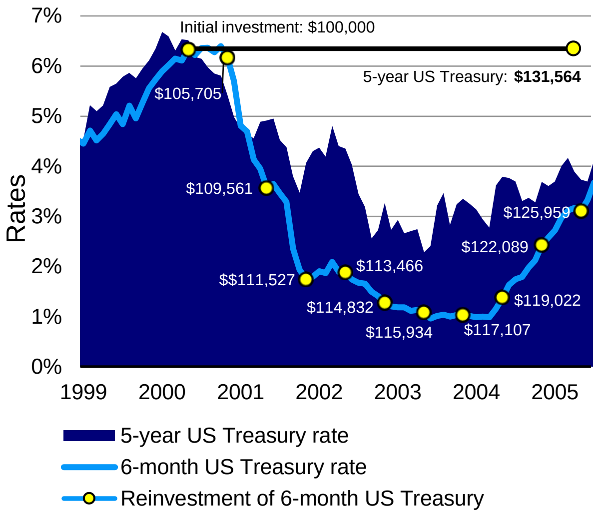
Sources: Bloomberg L.P., 12/31/23. Large-cap stocks are represented by the S&P 500 Index, including dividends. High yield bonds are represented by Bloomberg US Corporate High Yield Bond Index. Corporate bonds are represented by Bloomberg US Corporate Bond Index. Government bonds are represented by the Bloomberg US Treasury Index. Cash-like instruments are represented by the S&P US Treasury Index 0-1 Year Index. Inflation is represented by the Consumer Price Index. The charts are hypothetical examples, which are shown for illustrative purposes only, and do not predict or depict the performance of any investment. An investment cannot be made directly into an index. Index definitions can be found in the appendix. **Past performance does not guarantee future results.**

Reinvestment risk:
Locking in longer-term rates could be a better strategy

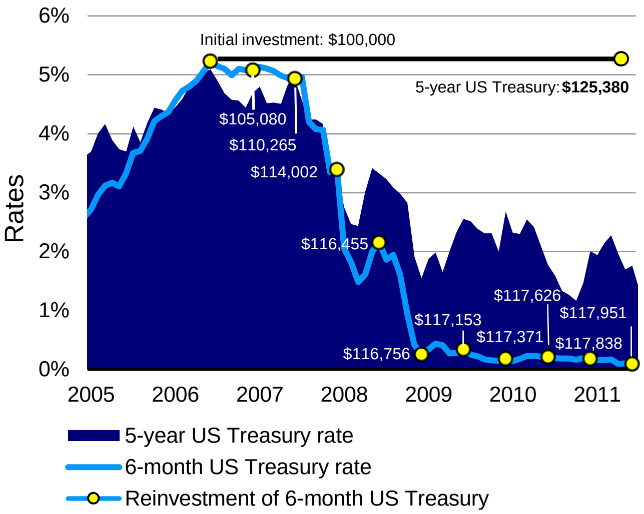
Reinvestment risk is the probability that an investor won't be able to reinvest cash flows, such as coupon payments, at a rate equal to their current return. It's among the biggest challenges of investing in short-term securities.

In May 2000 and June 2006, short-term interest rates were as attractive as long-term rates. In both examples, investing in a 5-year US Treasury and "locking in" the yield was a better approach than taking advantage of the elevated short-term yield and reinvesting at lower rates when short-term yields declined.

May 2000: 6-month and 5-year US Treasury rates



June 2006: 6-month and 5-year US Treasury rates



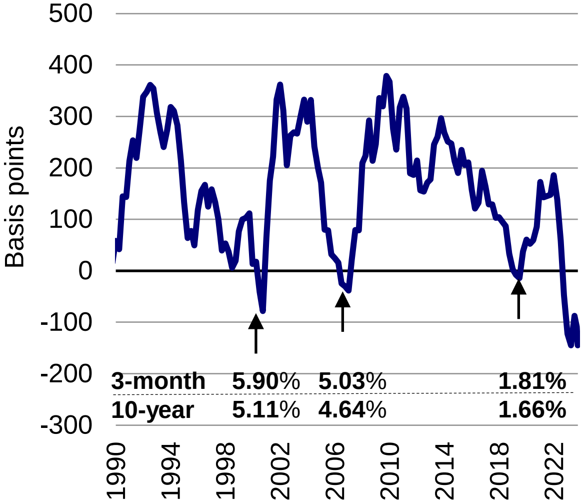
Source: Bloomberg L.P, 12/31/23. For illustrative purposes only. **Past performance does not guarantee future results.**

Duration:
Long-term bonds have outperformed after peak yield curve inversions

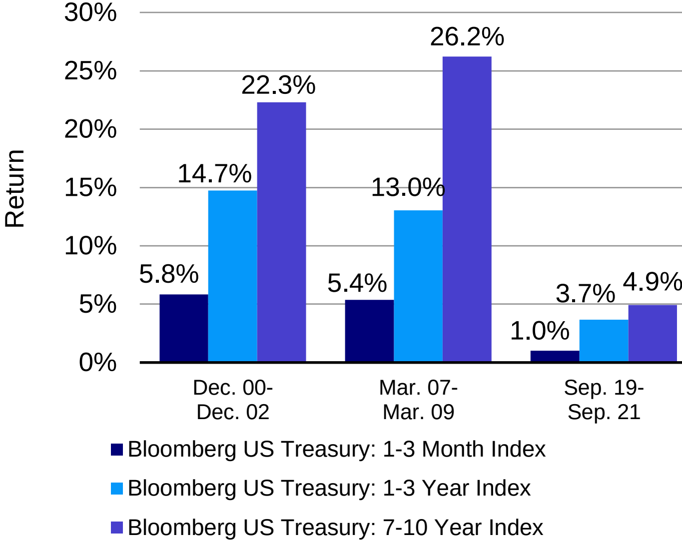
Inverted yield curves, when short-term interest rates are higher than long-term rates, often prompt investors to invest in shorter-term securities.

Intermediate- and longer-term government bonds, however, have outperformed shorter-term bonds following the last three peak inversions of the US Treasury yield curve.

US Treasury yield curve: 10-year rate minus 3-month rate



Short-term and long-term US Treasury bonds cumulative performance two years after peak inversion



Source: Bloomberg L.P., 12/31/23. A basis point is one-hundredth of a percentage point. An investment cannot be made into an index. **Past performance does not guarantee future results.**

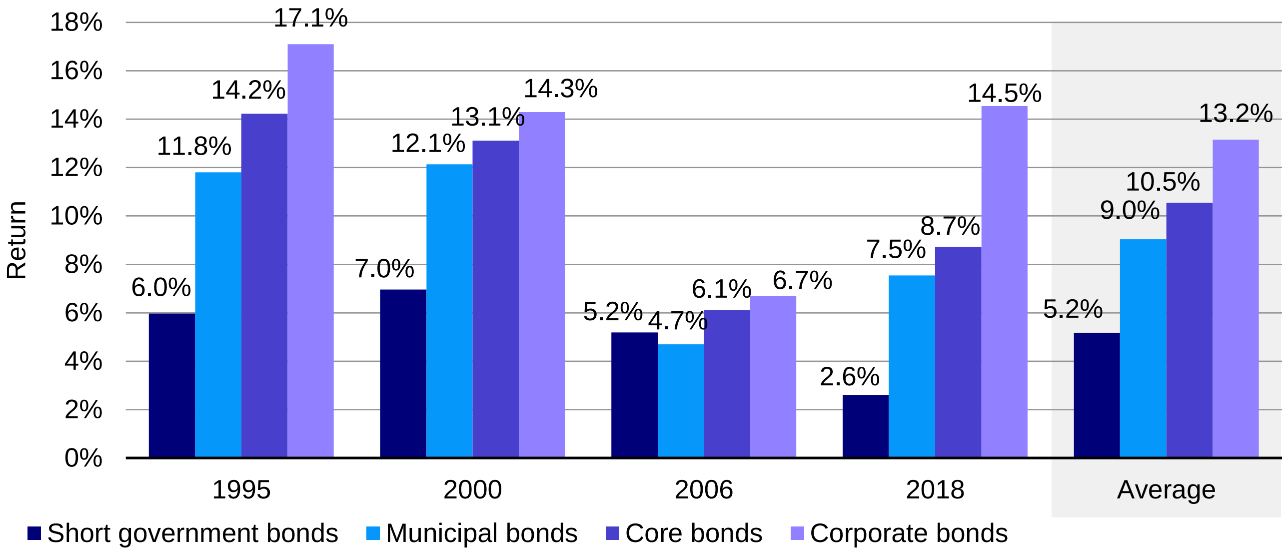
Strategies to consider for excess cash

Credit/munis:
Performed well in the aftermath of rate hikes

It's not just intermediate- and long-term government bonds that have outperformed following an inversion (or, in the case of 1995, a near inversion) of the yield curve.

The yield curve has tended to normalize (short rates falling below long rates) in the immediate aftermath of interest rate hikes by the US Federal Reserve. Over the next year, short-term bonds generally underperformed municipal bonds, core bonds, and corporate bonds.

Select bond indexes: 1-year returns following the end of rate hikes

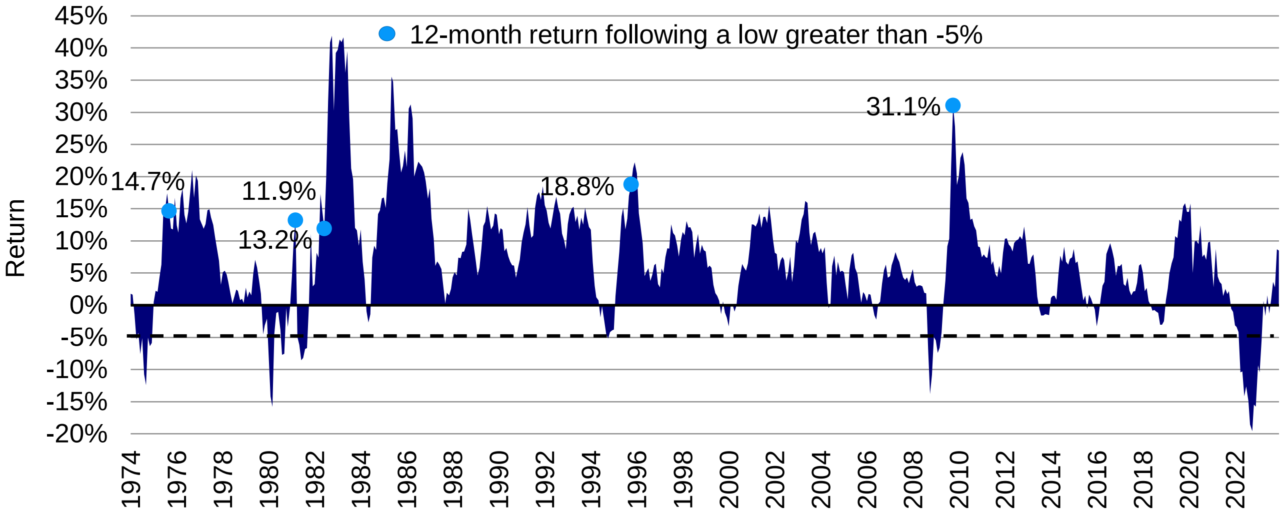


Sources: Bloomberg L.P., 12/31/23. Short government bonds are represented by the S&P 0-1 Year US Treasury Index. Municipal bonds are represented by the Bloomberg US Municipal Bond Index. Core bonds are represented by the Bloomberg US Aggregate Bond Index. Corporate bonds are represented by the Bloomberg US Corporate Bond Index. Indexes cannot be purchased directly by investors. **Past performance does not guarantee future results.**

Credit:
Downturns in corporate bonds have historically been buying opportunities

In fact, downturns in corporate bonds, which have typically occurred during periods of monetary policy tightening, have historically represented buying opportunities during the next year.

Bloomberg US Corporate Bond Index: Rolling 12-month returns



Sources: Macrobond, Bloomberg L.P., 12/31/23. Historical analysis reviews Bloomberg US Corporate Index annualized rolling 12-month total return data dating back to index inception (1/31/1973). An investment cannot be made in an index. **Past performance is not a guarantee of future results.**

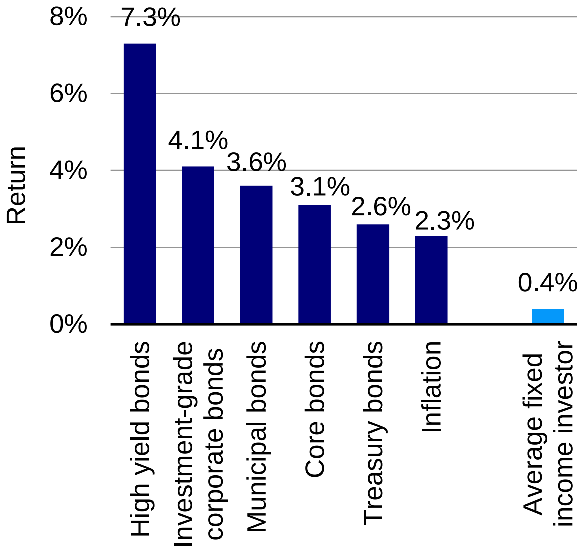
Timing the market has rarely worked

A reminder of the folly of trying to time the fixed income markets.

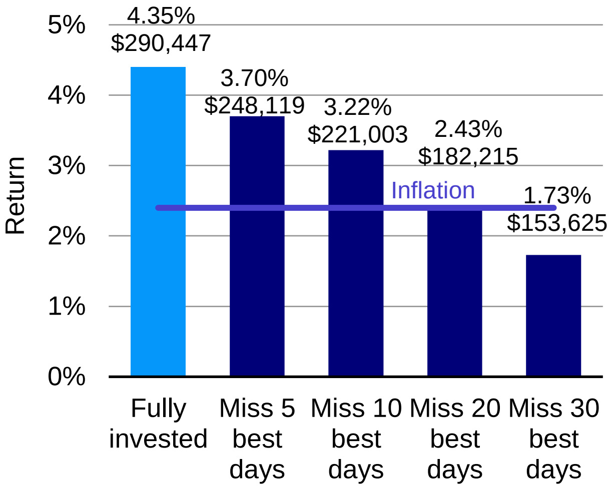
The average fixed income investor significantly underperformed other fixed income investments and didn't keep up with inflation over the last 20 years.

Missing even the best days in the core bond market has significantly reduced returns over time.

20-year annualized return (2002-2022)*



Bloomberg US Aggregate Bond Index annualized return and growth of $100K (1999-2023)



Sources: Bloomberg L.P., 12/31/23. Average asset allocation investor return is based on an analysis by DALBAR, Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. * Latest data available. Dalbar study with 2023 year-end numbers is available in March 2024. Indexes shown: Bloomberg US High Yield Corporate Bond Index, Bloomberg US Corporate Bond Index, Bloomberg Municipal Bond Index, Bloomberg US Aggregate Bond Index, and Bloomberg US Treasury Index. Inflation is measured by Consumer Price Index. Indexes are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any investment. **Past performance does not guarantee future results.**

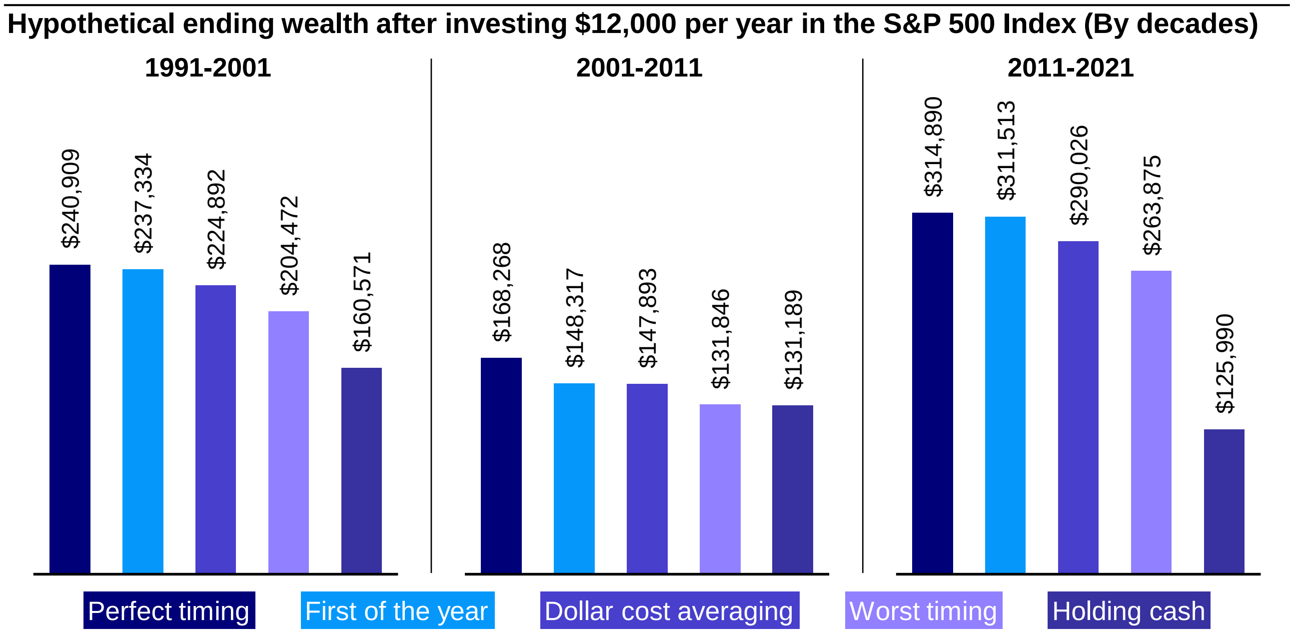
Strategies for getting out of cash

How should investors approach allocating their money out of cash?

Let's look at three instances when cash balances were elevated — following the 1991 recession, the 2001 recession, and in the aftermath of the Global Financial Crisis/European debt crisis.

In each instance, investors were better off investing their money in equities versus holding cash, regardless of how they did it. Investing on the first days of the year or dollar cost averaging ($1,000 per month) were sound strategies.

All investors wish they could have perfect timing, but even having the worst timing each year still outperformed cash.



Sources: Bloomberg L.P., Invesco, 12/31/23. Assumes $12,000 invested yearly into a hypothetical S&P 500 Index portfolio. Cash return is based on return of $12,000 invested yearly in a hypothetical portfolio of 3-month Treasury bonds represented by the Bloomberg 1-3 Month US Treasury Index. Perfect timing (worst timing) assumes that you maximize (minimize) your return in the S&P 500 Index each year. Dollar cost averaging assumes a $1,000 per month investment in the S&P 500 Index yearly. For illustrative purposes only and not meant to depict or predict the performance of any strategies. Indexes cannot be purchased directly by investors. **Past performance does not guarantee future results.**

Index definitions

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Core CPI is the same measure, but with food and energy goods and services removed from the basket.

The Bloomberg US Aggregate Bond Index is an index of US government and corporate bonds that includes reinvestment of dividends.

The Bloomberg US Corporate Bond Index measures the investment grade, fixed-rate, and taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility, and financial issuers.

The Bloomberg US Corporate High Yield Bond Index covers the universe of fixed-rate, non-investment grade debt.

The Bloomberg US Municipal Bond Index is a rules-based, market-value-weighted index engineered for the long-term tax-exempt bond market and includes bonds rated investment grade by at least two of the three major rating agencies (Moody's, S&P, and Fitch).

The Bloomberg US Treasury Index is an unmanaged index of public obligations of the US Treasury with remaining maturities of one year or more.

The Bloomberg 1-3 Month US Treasury Index is an unmanaged index of public US Treasury obligations with remaining maturities of one to three months.

The Bloomberg 1-3 Year US Treasury Index is an unmanaged index of public US Treasury obligations with remaining maturities of one to three years.

The Bloomberg 7-10 Year US Treasury Index is an unmanaged index of public US Treasury obligations with remaining maturities of seven to 10 years.

The S&P US Treasury Bond 0-1 Year Index is designed to measure the performance of US Treasury bonds maturing in 0 to 1 years.

The S&P 500® Index is a capitalization-weighted index of 500 stocks intended to be a representative sample of leading companies in leading industries within the US economy. Index includes reinvestment of dividends but does not include fees, expenses, or taxes.

Indexes are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any investment. **Past performance does not guarantee future results.**

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Risks:

- All investing involves risk, including the risk of loss. In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.
- Treasury securities are backed by the full faith and credit of the US government as to the timely payment of principal and interest.
- Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating. Junk bond values fluctuate more than high quality bonds and can decline significantly over a short time.
- Municipal securities are subject to the risk that legislative or economic conditions could affect an issuer's ability to make payments of principal and/ or interest.

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Most references are US-centric and may not apply to Canada. All data is USD, unless otherwise stated.

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