MANAGED ASSET PORTFOLIOS

Money Market Funds: Dangers Of Market Timing

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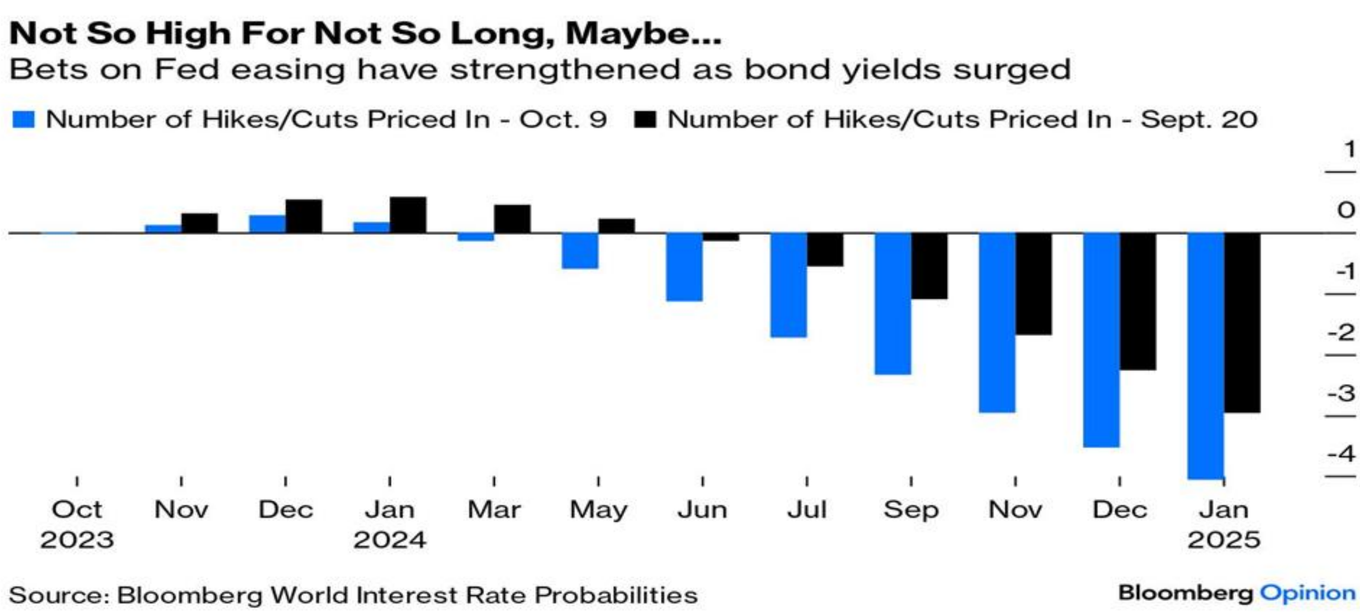
We have often discussed the risks inherent in market timing. While in the past we have centered these discussions around the stock markets, the same holds true for other asset classes. As a reminder, market timing entails making buy or sell decisions based on predictions of short-term market price movements and are typically made on specific assets rather than a particular security. In this case, it appears investors are trying to time the bond market with money market funds.

For the first time since 2007, money market funds provide investors with yields of greater than 5%, with the average rate of 5.15% according to Crane Data, which is the highest average level since 1999.[1] This has been welcomed during a year of volatility, particularly for those investors starving for yield for more than a decade. With the exception of the Magnificent Seven (Alphabet, Amazon, Apple, Meta, Microsoft, Nivida, and Tesla), the performance of the broader markets has been uninspiring, and bonds appear on pace for their third consecutive losing year. Assuming current trends continue, this marks the first time bond prices have declined for a consecutive three-year period. Investors have viewed this as an opportunity, piling into money market funds, adding $632 billion of net inflows in 2023.[2] While money market funds can serve as a valuable asset class, primarily for liquidity purposes, we caution against overusing them as part of the cornerstone of your portfolio.

As stock prices tend to fall quicker than they rise, so too do interest rates. As an example, it took the Federal Reserve (the Fed) two and half years, beginning in 1972, to raise interest rates by a whopping 9.75%, only to take them down by seven percentage points in just one year. Before the Great Financial Crisis, it took the Fed over three years to raise rates from one percent to 5.25% and only a year and a half to take them to zero. Trying to time interest rate cuts is difficult. We note, however, that weighted average maturities (WAM) of money market funds cannot exceed 60 days. Hence, when rates do begin to fall, money market yields will likely fall shortly after that. With that said, a year ago, Wall Street was forecasting interest rate cuts for the second half of 2023. Today, Wall Street is not ruling out another increase this year and is now forecasting the first cut in September 2024. However, to our point about timing, these forecasts remain volatile. As of October 9th, the market is already pricing in one more hike in 2024 than it was on September 20th.



At MAP, we continue to forecast that inflation will likely remain above the Fed's desired target of two percent for the foreseeable future, supportive of interest rates remaining higher for longer. However, should the economy encounter a material slowdown, the Fed would likely cut rates sooner rather than later.

Just as Goldilocks went searching for porridge that was not too hot or too cold and a bed that was not too hard or too soft, a fixed income investor should not seek out portfolios that are too long in maturity or too short. Given our belief that inflation will likely remain above the Fed's two percent target (barring a significant economic downturn), we do not advocate owning longer-dated bonds (over 10 years). Conversely, we do not believe it is prudent to invest heavily into money market funds. Instead, we suggest that investors apply a Goldilocks strategy to the fixed-income portion of their portfolio – specifically, keeping maturities on the shorter side to protect against higher rates stemming from stubbornly high inflation, while laddering out maturities a few years to take advantage of the still inverted yield curve that we have experienced over the past couple of months. As we pen this piece, we are currently looking to add more intermediate-term maturities in our fixed income portfolios to serve that purpose. We believe this approach offers two benefits: First, shorter maturities can be reinvested if rates continue to rise, while reducing the downside from duration. Second, we believe the intermediate maturities, specifically those with duration less than their maturities, offer a good hedge if rates do begin to decline, while still locking in rates near five percent for the next half-decade.

MAP offers two investment strategies that we believe are well-positioned to take advantage of the current interest rate environment: The Global Balanced Composite (with and without covered calls) and the Enhanced Income Composite. The Balanced strategies currently have about 40% of their holdings in shorter-term bonds (mostly corporates), but also a few Treasury Inflation Protected Securities (TIPS) and Certificates of Deposit (mostly purchased in the March/April timeframe when dislocation in the banking sector forced banks to pay up for deposits). The remaining portion of the portfolio is in dividend-paying stocks. The Enhanced Income Composite is approximately 90 percent fixed income (same characteristics as the Balanced strategies), with the remainder in dividend-paying stocks.

For more information on these strategies, please contact your MAP representative.

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[1]https://www.foxbusiness.com/markets/money-market-funds-hit-record-investors-jump-5-percent-returns
[2]https://www.barrons.com/articles/best-money-market-funds-9ffd8f1b

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