RAYMOND JAMES | INVESTMENT MANAGEMENT

Cash is so last year.

Why 2024 looks better for fixed income investing.

Long-duration bonds:

Falling rates means rising opportunity

With short-term investment vehicles advertising temporary yields of more than 5%, 2023 was a banner year for money market funds, with total fund assets topping $5.8 trillion by year's end.[1]

And in uncertain markets, allocations to cash and cash equivalents can be prudent. In December, however, the U.S. Federal Reserve signaled that the record acceleration of monetary policy in 2022 and 2023 might have reached its peak, opening the door to possible interest rate cuts starting in 2024.

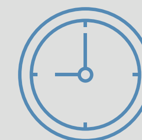
In a falling-rate environment, the portfolio teams at Raymond James Investment Management and its boutique investment managers believe that the money market instruments of 2023 are no longer in the best interest of long-term investors. Instead, they see 2024 as the time to consider making the switch into more traditional implementations of fixed income – in particular, longer-duration bonds – before rates begin to fall.

[1] Source: Bloomberg; Money Market Fund Assets, Jan. 4, 2024, Investment Company Institute (ICI), as of 12/27/2023.

Choosing the right vehicle for the environment

Higher rates are more profitable for fixed income investors, but they usually come at the end of a Fed rate-hiking cycle, typically followed by rate cuts. The short-term Treasury bills and certificates of deposit largely held by money market funds have two weaknesses in a falling interest rate environment:

- Short-dated instruments have limited room for capital appreciation, which restricts their ability to benefit from the inverse relationship between bond prices and interest rates.
- The rates of interest offered by money market instruments reset at the end of each term, meaning that they usually follow overall interest rates downward. In a more normalized environment, their lower yields pale in comparison to the returns of longer-term bonds or other instruments that are intended to be investment assets.



Money market rates may be attractive for the short term, but they ultimately do not serve the long-term investor.

Cash returns lag stocks and bonds after the Fed pauses rate hikes

Post Fed Rate Hike Pause Returns, Annualized

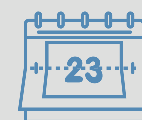
	1-Year Return			3-Year Return			5-Year Return		
Federal Funds Rate Hike Cycle	S&P 3-Month T-bill Index	Bloomberg U.S. Aggregate Bond Index	S&P 500	S&P 3-Month T-bill Index	Bloomberg U.S. Aggregate Bond Index	S&P 500	S&P 3-Month T-bill Index	Bloomberg U.S. Aggregate Bond Index	S&P 500
2/4/1994–2/1/1995	5.6%	17.1%[1]	39.2%[1]	5.3%	10.2%[1]	30.5%[1]	5.2%	7.3%[1]	26.8%[1]
6/30/1999–5/16/2000	6.0%	13.7%	-11.3%	3.4%	11.1%	-12.4%	2.6%	7.8%	-3.0%
6/30/2004–6/29/2006	5.1%	6.5%	20.3%	3.0%	6.6%	-8.0%	1.8%	6.6%	2.7%
12/16/2015–12/19/2018	2.2%	8.8%	30.4%	1.0%	4.9%	24.7%	1.9%	1.0%	15.7%

[1]Based on monthly returns rounded to the nearest month-end.
Source: Bloomberg, as of 12/31/23.

Duration bonds, such as Treasury bonds or corporate bonds, typically offer higher yields and fixed interest payments over an extended period. When interest rates decline, the values of existing bonds tend to rise, which gives bondholders the potential to benefit from capital appreciation.

Owning bonds with duration, rather than money market instruments, provides a tailwind to long-term investors in a falling interest rate environment in the view of the independent investment boutiques, including the Fixed Income Team at Eagle Asset Management, that are part of Raymond James Investment Management.

Money market rates may be attractive for the short term, but they ultimately do not serve the long-term investor. When investing in these shorter-term instruments, it is important to note that these rates are inherently promised for a short term and are reset at the end of the term. Investing in longer-term bonds allows for the yield to be earned over the life of those bonds assuming there are no credit events, which is why investors seeking reliable income streams over the long run tend to prefer high-grade credits.



Duration incorporates a bond's yield, coupon, final maturity, and call features into one number, expressed in years, that indicates how price-sensitive a bond or portfolio is to changes in interest rates. Bonds with higher durations carry more risk and have higher price volatility than bonds with lower durations environment in the view of the independent investment boutiques, including the Fixed Income Team at Eagle Asset Management, that are part of Raymond James Investment Management.

The chart below details an estimation of the yield profile for the 10-Year Treasury compared to money market rates and federal funds rate expectations laid out by the Federal Open Market Committee (FOMC). It details that for an investment of $1 million at current short-term rates, money market funds would need to keep their current rates for more than seven years before falling to FOMC projections to match the return of the 10-year Treasury over the same period. This is likely not a feasible scenario and is something we believe long-term investors need to keep in mind when making these changes.

10-year Treasury yields vs. money market returns

How long would a money market fund need to maintain its current rates to match the return of a 10-year Treasury note?

	Year										Total Yield		
Yield Scenario	1	2	3	4	5	6	7	8	9	10	Cumulative	$ Return, $1M invested	Annualized
10-Year U.S. Treasury Yield	4.83%	4.83%	4.83%	4.83%	4.83%	4.83%	4.83%	4.83%	4.83%	4.83%	60.27%	$1,602,660	4.83%
Short-Term Yield Breakeven	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%	4.86%	2.50%	2.50%	60.27%	$1,602,660	4.83%
FOMC Fed Funds Projections	5.63%	5.50%	4.63%	3.50%	2.75%	2.50%	2.50%	2.50%	2.50%	2.50%	40.28%	$1,402,801	3.44%

Scenario 1: Yield profile of a 10-year U.S. Treasury note with a yield-to-maturity of 4.83%.
Scenario 2: Yield profile based on the number of years the federal funds rate would have to stay around the current level of 5.50% before returning to the FOMC's projected long-term rate of 2.5% so that the yield profile of short-term fixed income assets over a 10-year period will equal the yield profile a 10-year U.S. Treasury note with a yield-to-maturity of 4.83% (Scenario 1).
Scenario 3: Yield profile based on the median of federal funds rate estimates as part of the FOMC's Summary of Economic Projections.
Source: Bloomberg, U.S. Federal Reserve, and Eagle estimates; data as of October 17, 2023.

Ultimately, while money markets can be used to supplement short-term cash needs, they are not investments. In today's environment, portfolio teams at Raymond James Investment Management's boutique investment managers see longer-duration bonds as very attractive at yields currently available and worth sacrificing shorter-term yields for higher longer-term ending values.

For more insights and analysis from Raymond James Investment Management, visit **Our Thinking**.

Risks associated with Fixed Income investing:

Many investors consider bonds to be “risk free” investment vehicles. Historically, bonds have indeed provided less volatility and less risk of loss of capital than has equity investing. However, there are many factors that may affect the risk and return profile of a fixed-income portfolio. The two most prominent factors are interest-rate movements and the creditworthiness of the bond issuer. Bonds issued by the U.S. government have significantly less risk of default than those issued by corporations and municipalities. However, the overall return on government bonds tends to be less than these other types of fixed-income securities. Investors should pay careful attention to the types of fixed-income securities that comprise their portfolio and remember that, as with all investments, there is the risk of the loss of capital.

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Definitions

Credits are a generic term for fixed income securities such as corporate bonds, mortgage- or asset-backed securities, municipal bonds, or emerging market bonds.

Duration incorporates a bond’s yield, coupon, final maturity, and call features into one number, expressed in years, that indicates how price-sensitive a bond or portfolio is to changes in interest rates. Bonds with higher durations carry more risk and have higher price volatility than bonds with lower durations.

The federal funds rate, known as the fed funds rate, is the target interest rate set by the Federal Open Market Committee of the U.S. Federal Reserve. The target is the Fed’s suggested rate for commercial banks to borrow and lend their excess reserves to each other overnight.

The Federal Open Market Committee (FOMC) consists of 12 members: the seven members of the Board of Governors of the Federal Reserve System; the president of the Federal Reserve Bank of New York; and four of the remaining 11 Reserve Bank presidents, who serve one-year terms on a rotating basis. The FOMC holds eight regularly scheduled meetings per year at which it reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth.

Indices

The S&P 500 Index measures change in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 80% of the investable U.S. equity market.

The S&P U.S. Treasury Bill Current 3-Month Index is designed to measure the most current three-month U.S. Treasury Bill.

The Bloomberg U.S. Aggregate Bond Index is composed of the total U.S. investment-grade bond market. The market-weighted index includes Treasuries, agencies, commercial mortgage-backed securities (CMBS), asset-backed securities (ABS) and investment-grade corporates.

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About Raymond James Investment Management

Raymond James Investment Management is a global asset management company that combines the exceptional insight and agility of individual investment teams with the strength and stability of a full-service firm. Together with our boutique investment managers – Chartwell Investment Partners, ClariVest Asset Management, Cougar Global Investments, Eagle Asset Management, Reams Asset Management (a division of Scout Investments) and Scout Investments – we offer a range of investment strategies and asset classes, each with a focus on risk-adjusted returns and alpha generation. We believe providing a lineup of seasoned, committed portfolio managers – spanning a wide range of disciplines and investing vehicles – is the best way to help investors seek their long-term financial goals.

About Eagle Asset Management

Eagle Asset Management provides a broad array of fundamental equity and fixed-income strategies designed to meet the long-term goals of institutional and individual investors. Eagle's multiple independent investment teams have the autonomy to pursue investment decisions guided by their individual philosophies and strategies.

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