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Stable value: Why stay the course through the rate cycle?

From the Field
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Key Insights

- With the Fed at the end of its rate-hiking cycle, money market fund yields may have peaked, while stable value crediting rates could continue to move higher.
- Despite a prolonged period of money market funds outyielding stable value, many plan sponsors have chosen to stay the course with stable value.
- While higher interest rates have presented some challenges, we believe there are unique investment opportunities for stable value.

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After looking at prior U.S. Federal Reserve easing cycles, we examined index performance comparisons between money market, stable value, and other low duration fixed income strategies such as ultra short-term bond and short-term bond.

How did stable value fare in prior easing cycles?

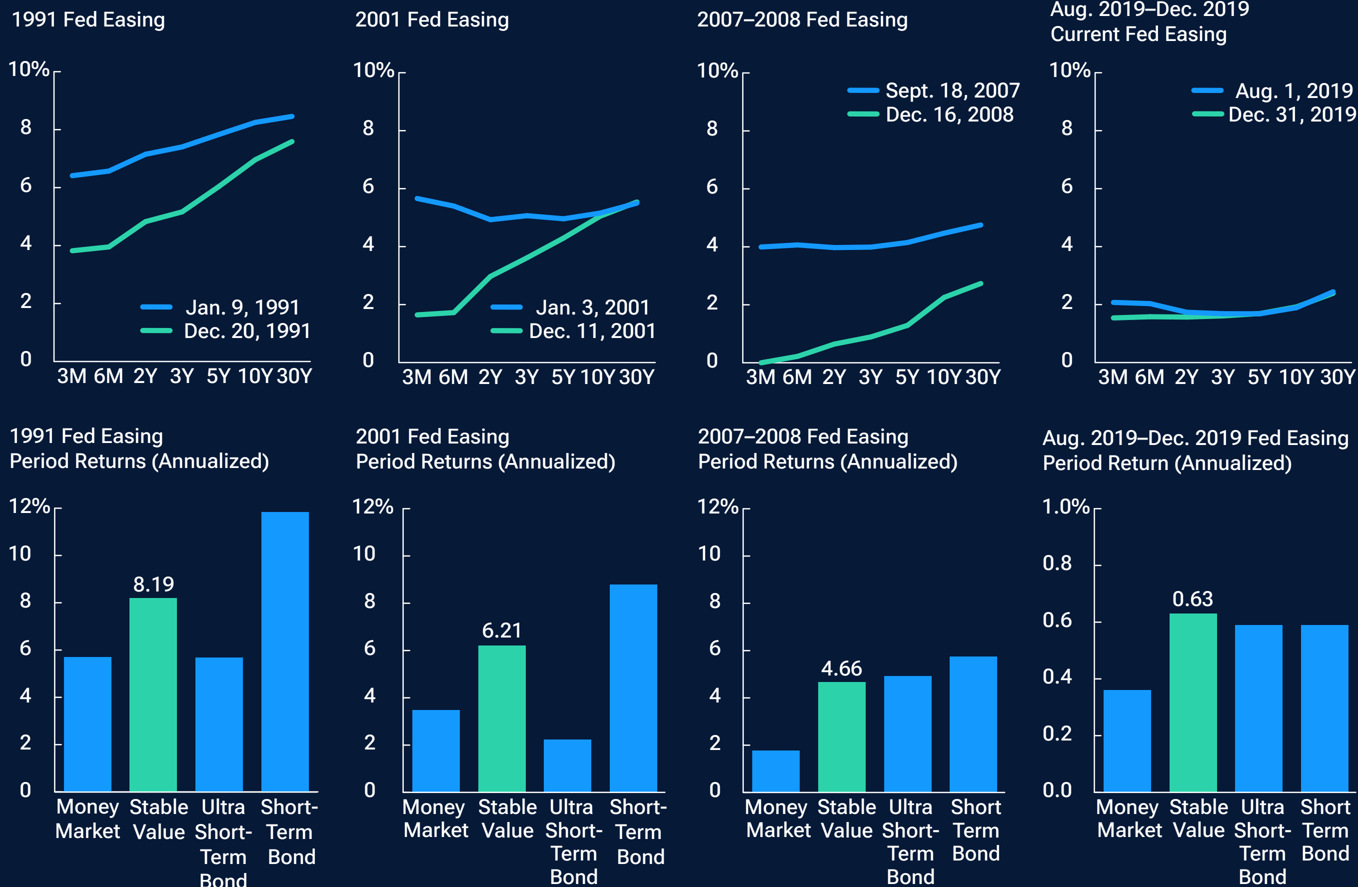
Notably, as seen in Figure 1, stable value has performed well relative to money market funds in prior easing cycles. The recent period of strong money market performance versus stable value speaks to the magnitude and compressed time frame of the Fed's current hiking cycle. However, stable value could be an attractive option as the Fed begins loosening monetary policy.

Similarly, we can see the unique effects of the most recent tightening cycle when we compare money market yields with stable value crediting rates over recent decades. Again, speaking to the magnitude of the recent hiking cycle, we see in Figure 2 that money market fund yields exceeded stable value crediting rates by a wide margin for the first time in several years. In prior hiking cycles, money market fund yields moved up to or slightly exceeded stable value crediting rates, but this hiking cycle has been different.

Historically, stable value crediting rates, given their longer portfolio durations, typically lagged money market fund yields in a rising rate environment. However, on a positive note, stable value crediting rates have also typically lagged money market yields on the way down as the Fed starts cutting rates.

Stable value did well in prior easing rate environments

(Fig. 1) Historical rate-easing cycles and low duration performance



As of June 30, 2024.
Past performance is not a reliable indicator of future performance.
Money market funds and stable value products have different risks, including the possible loss of principal. It is important that you carefully review the legal documents for each type of vehicle to determine if it is appropriate for you prior to investment.
Money Market is represented by the Lipper U.S. Treasury Money Market Index, Ultra Short-Term Bond is represented by the Bloomberg 9-12 Month T-Bill Index, Short-Term Bond is represented by the Bloomberg U.S. 1-3 Year Government/Credit Bond Index, Stable Value is represented by the Morningstar US CIT Stable Value Index, Ultra Short-Term Bond is represented by the Bloomberg 6-Month Bellweather Index for the 1991 Fed easing cycle.
Data provided on this page include the historical information of the Hueler Pooled Fund Index through December 31, 2020, and the Morningstar US CIT Stable Value Index from January 31, 2021, to current period ending date.
Source: U.S. Department of the Treasury.
Please see Additional Disclosures page for sourcing information.

With the Fed closer to the end of its rate-hiking cycle, money market fund yields may have peaked, while stable value crediting rates could continue to move higher.

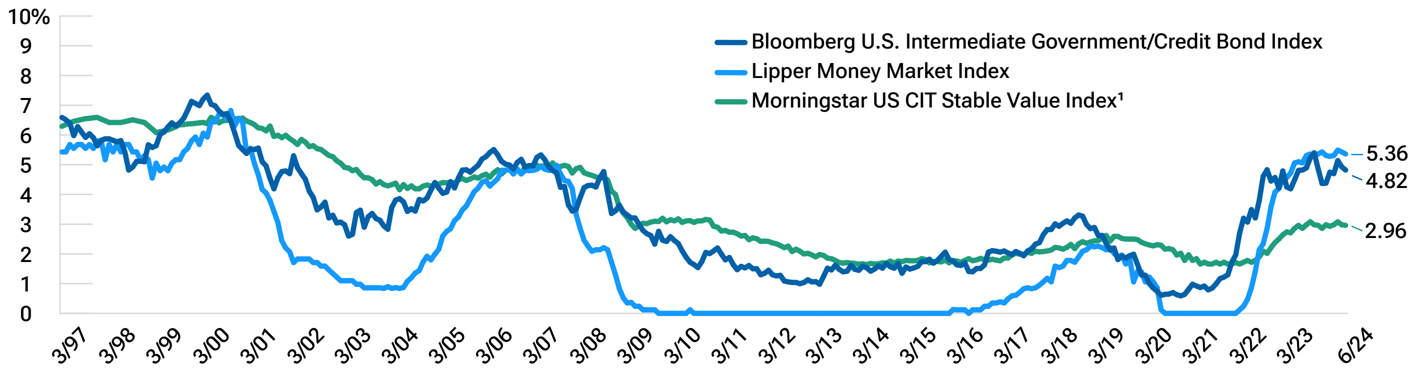
The Bloomberg U.S. Intermediate Government/Credit Bond Index (Intermediate Bond Index) is highlighted in Figure 2, and we believe this index is a good proxy for where stable value managers can reinvest maturing stable value portfolio assets or reallocate to capture attractive yield. As illustrated in the chart, the Intermediate Bond Index's yield is also elevated and notably exceeds stable value crediting rates, which should bode well for higher crediting rates in the future.

Stable value separate accounts as an attractive alternative

Despite a prolonged period of money market funds outyielding stable value, advisors and plan sponsors have chosen to stay the course with stable value as recent search

Annualized yield comparison

(Fig. 2) Stable value has historically maintained competitive yields



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[1] Universe rates of return are reported gross of management fees.

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activity has been muted and stable value fund put queues have been manageable. Retirement plan sponsors may be wondering: Is this a good time to add stable value to a plan lineup or to convert a money market option to a stable value separate account offering?

It has been our experience, at this point in the interest rate cycle where fed fund rates and money market fund yields are likely peaking, that launching a new stable value separate account portfolio at par can be an attractive alternative.

Converting a money market product to a new stable value separate account at par (100% market-to-book value ratio) should allow the stable value separate account portfolio access to potentially rising crediting rates as intermediate-term bond yields are elevated as highlighted in Figure 2. As noted earlier, the Intermediate Bond Index is a good proxy for where stable value managers can reinvest maturing stable value portfolio assets.

In addition to competitive crediting rates, new stable value separate accounts may also offer strong market-to-book value ratios and performance going forward relative to money market funds even in an easing rate environment, as highlighted by the historical data shown in Figure 1.

Conclusion

The magnitude and compressed time frame for the most recent hiking cycle has inflated money market yields and helped drive strong returns for money market funds. For the first time in more than 20 years, money market fund yields have exceeded stable value crediting rates by a wide margin, and money market funds have outperformed stable value.

However, we believe stable value offerings remain attractive, as they should benefit from their longer portfolio durations as stable value crediting rates have typically lagged money market fund yields on the way up in a rising rate environment and on the way down as the Fed starts cutting rates. While higher interest rates have presented some challenges, we believe there are unique investment opportunities for stable value. Additionally, we think converting to a stable value product from a money market option is an attractive option for plan sponsors to consider based on the current rate environment and the elevated yields available.

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Glossary of terms:

Market-to-Book Value - A ratio of the market value of a stable value fund's underlying assets to the book value of its stable value contracts—can be an indicator in assessing the overall "health" of a stable value fund.

Crediting Rate - The crediting rate is the interest rate earned on the contract value (principal plus accrued income) expressed as an effective annual yield.

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