Why it’s time to consider moving out of cash and into fixed income

From the Field
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Key Insights

- It is time for investors to consider stepping out of cash as rates are expected to fall with the Federal Reserve now in an interest rate cutting cycle.
- We believe fixed income is an attractive place to redeploy cash, particularly for investors seeking to lock in income as bond yields remain at elevated levels.
- With diverse sectors, fixed income solutions can potentially help support investors with a range of goals and risk tolerances.

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The days of cash being king are numbered. With the Federal Reserve now in an interest rate cutting cycle, cash rates are likely to move lower. Against this backdrop, we believe it is time for investors to consider redeploying cash into the market. But where? With bond yields still at elevated levels, we believe that fixed income is an attractive asset class for putting cash to work—especially for investors seeking to lock in income.

Why we believe it’s time to step out of cash

Cash has been king these past few years. The combination of market uncertainty and high short-term interest rates have resulted in a record amount of money held in money market funds. But the Federal Reserve is now in a monetary policy easing cycle, so the amount of income earned on cash balances will start to fall. Furthermore, staying parked in cash over a medium- and long-term horizon could mean missing out on capital appreciation opportunities elsewhere. Against this backdrop, we believe it is a good time to begin redeploying cash.

Why move into fixed income?

With bond yields still at elevated levels relative to much of the post-global financial crisis recovery, we believe fixed income is an attractive place to deploy cash. Fixed income also has diverse sector options that support

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Bond solutions for a range of economic environments

(Fig. 1) Strategies conducive to a growth, deterioration, or stagflation scenario

Growth	Deterioration	Stagflation
Seek strategies that offer potential high income.	Seek strategies that offer potential high quality.	Seek strategies that offer potential diversification.
— High yield corporate bonds — Global multi-sector bond	— Government bonds — Investment-grade corporate bonds	— Absolute return bond — Multi-asset credit

As of October 2024.
For illustrative purposes only. This is not to be construed to be investment advice or a recommendation to take any particular investment action. Investments involve risks, including possible loss of principal. **Diversification cannot assure a profit or protect against loss in a declining market.**
Source: T. Rowe Price.

a range of goals and risk tolerances. It offers opportunities for both defense and capital appreciation. The fragmented nature of the asset class means that what drives one sector of the market is different from what drives another, so there's often a wide dispersion among sector returns. This provides flexibility to choose sectors that suit distinct needs—generating consistent income, capital appreciation, or defense against equity market volatility.

Fixed income and equity markets have tended to move in tandem in recent years. This understandably raises questions about whether bonds can still deliver the benefits of diversification seen historically. Correlations[1] between the asset classes could continue to be volatile. However, if an extreme market event or significant downturn puts major selling pressure on risk assets such as equity, we expect high-quality government and corporate bonds to be effective diversifiers. At a minimum, they should provide longer-term investors with potential liquidity—therefore, optionality—needed to make portfolio adjustments in times of stress.

Bond solutions for different market environments

Given the volatility and uncertainty in markets in recent years, investors may be feeling apprehensive about stepping out of cash. But regardless of how they expect the market environment to evolve, we believe that investors can find a solution in fixed income to mitigate risks and address their objectives. Below, we explore three economic scenarios and the bond strategies potentially conducive to each.

Scenario 1: Growth

Investment solution: High income. Investors anticipating a scenario of moderate economic growth should consider high yield strategies as the healthy macro environment will likely be credit supportive. The risk of a significant credit spread[2] widening is less of a concern in this environment, which should allow for potential comfortable income accumulation. Furthermore, current all-in yields available in high yield are attractive, so it's a good time to potentially lock in high income. As of the end of September 2024, the average yield in global high yield corporate bonds was around 7.13%, which is higher than the average yield of 6.52% observed in the last 10 years.[3]

[1] Correlation measures how one asset class, style or individual group may be related to another. A perfect positive correlation means that the correlation coefficient is exactly 1. This implies that as one security moves, either up or down, the other security moves in lockstep, in the same direction. A perfect negative correlation means that two assets move in opposite directions, while a zero correlation implies no relationship at all.
[2] Credit spreads measure the additional yield that investors demand for holding a bond with credit risk over a similar-maturity, high-quality government security.
[3] As of September 30, 2024. Yield to worst of the ICE BofA Global High Yield Index. **Past performance is not a reliable indicator of future performance.** Source: ICE BofA. See Additional Disclosures.

A higher-quality global multi-sector bond approach is another appealing option. It can offer attractive income potential and diversified return sources. These types of solutions provide exposure to a variety of sectors, including governments and securitized, investment-grade, and high yield corporate bonds. The broad range of sectors offers the potential to diversify alpha sources and lower volatility.

Scenario 2: Deterioration

Investment solution: High quality. A deterioration scenario would involve a decline in economic activity and deceleration of inflation, leading to more interest rate cuts. For investors worried about this scenario, investment solutions that are higher quality can be useful, such as developed government bonds where there's typically better liquidity than other fixed income segments. Furthermore, government bond yields are still high when compared with much of the post-global financial crisis period.

Investment-grade corporate bond strategies also offer a potential combination of consistent income and high-quality duration. For example, the average yield in European investment-grade corporate bonds stood at around 3.36% at the end of September—which is well above the average level of 1.55% observed in the last decade.[4]

Scenario 3: Stagflation

Investment solution: Diversification. A stagflation scenario would involve inflation reaccelerating and economic growth slowing. This could lead to interest rate rises and weakness in risk markets, such as equity. Such an environment can be challenging for investors. But a good way to navigate is through utilizing alternative and very active management strategies that can potentially benefit from higher volatility. In particular, investors should consider solutions that can generate income while seeking to minimize interest rate risk and mitigate against severe risk-off events. These include flexible strategies, such as absolute return. These are typically benchmark agnostic and can cast a broader net, with the potential to invest in a wide range of geographies, sectors, and security types. However, strategies within this category can vary significantly. If an investor is seeking diversification, it's important to choose an approach that has either low or negative correlation with key market indexes, such as the S&P 500 Index.

Lower-beta multi-asset credit strategies can also work in this scenario. The latter offers the ability to find diverse alpha sources across the broad credit market. Approaches that actively manage credit beta and duration risk can help to navigate volatile environments.

The combination of political uncertainty, the soft global growth environment, and heightened geopolitical risks may be unsettling for some investors—keeping many parked in cash. But with bond yields still at elevated levels, it is time to consider redeploying those cash assets to potentially lock in income at these attractive levels. In today's ever-evolving landscape, fixed income offers a wide range of opportunities, including strategies for income, defense, or capital appreciation purposes. Choosing an approach that prioritizes quality active research is essential. This can give investors greater confidence about shifting their cash holdings to take potential advantage of the attractive all-in yields that are available.

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[4] As of September 30, 2024. Yield to worst of the Bloomberg Euro Aggregate—Corporate Bond Index. **Past performance is not a reliable indicator of future performance.** Source: Bloomberg Finance L.P.

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