Portfolio Perspectives

DAVIDSON INVESTMENT ADVISORS

Lock It In

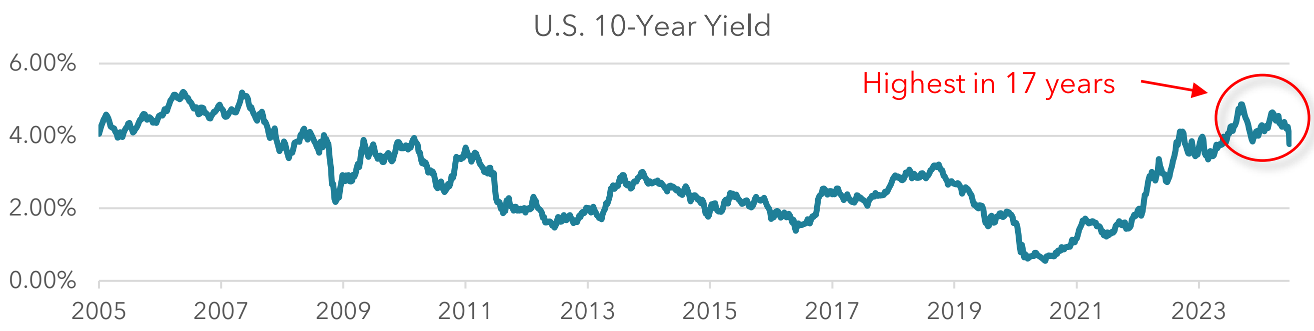
Now might be the time to extend duration on cash holdings

Talking about investment risk is part of our language and DNA as financial professionals. Generally, risk is thought of by retail investors in terms of volatility or the possibility of loss. However, we often remind ourselves that opportunity cost is another potential hinderance to long-term investment results. In our view, one of the most relevant risks today may be staying idle with assets that could be allocated to longer-duration fixed income as global banks start cutting rates.

According to Bloomberg, investors today hold over $6 trillion in money market funds – double the average for the past 30 years. While such holdings make sense in an inverted yield curve environment from a short-term yield perspective, we believe now may be an opportune time to reposition some of that cash and lock in yields at elevated rates.

Absolute Yields Appear Attractive

Still fresh off a period of historically low interest rates, our team notes that yields in longer-dated bonds look attractive at this point, up substantially from COVID-era lows. We also note this new interest rate regime allows for positive real yields for fixed income investors - a welcome development off a period of higher-than-normal inflation.



Source: Bloomberg , as of August 5, 2024

Finally, when considering taxes for high income earners, we are particularly attracted to the tax-equivalent yields presented in the investment grade muni market at this point.

Term	Issuer	Coupon	Ratings	Yield to Worst	Yield to Maturity	Tax Equivalent Yield to Worst	Tax Equivalent Yield to Maturity
3yr	Portland OR Sewer System	5.00%	Aa2/AA	2.62	2.62	4.42	4.42
16yr	New York State	4.00%	AA+	3.85	3.93	6.50	6.63
17yr	Chesterfield County, VA	4.00%	Aaa/AAA	3.76	3.84	6.35	6.49
18yr	Tooele County, UT	4.00%	A1	4.00	4.00	6.75	6.75

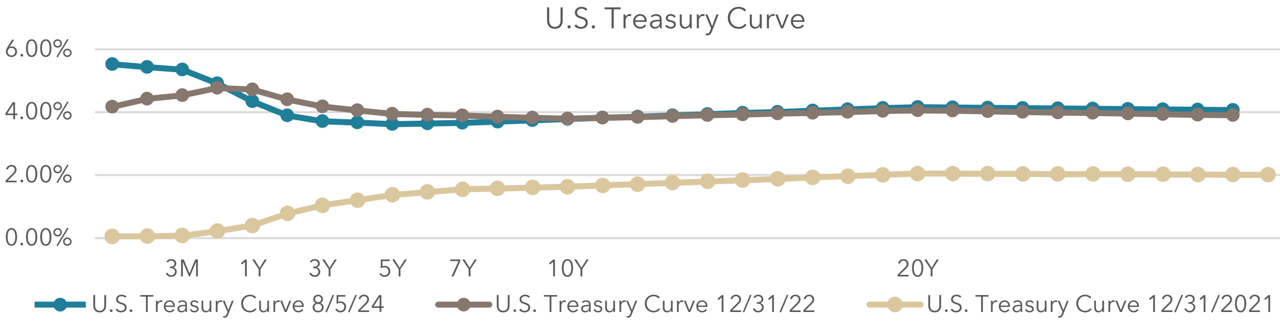
Source: Bloomberg , as of August 5, 2024

Many clients remain sensitive to the idea that yields on longer-duration fixed income instruments remain below those available on ultra-short investment options such as CD's and money market funds. However, we believe it makes sense to hedge against the reinvestment risk of those short instruments in a falling rate environment by taking advantage of the yields and total return opportunities presented by longer-duration assets.

Cutting Cycle Ahead?

The Federal Reserve has made its intention to pivot from a rate hiking cycle to a rate cut cycle abundantly clear. The questions on many investors' minds are twofold: 1) when will rate cuts commence, and 2) how far will short rates drop?

While we at Davidson Investment Advisors cannot answer either of those questions with complete confidence and precision, we are of the belief that cuts will come soon. For investors that share this opinion, we note that in recent history, it has been better for investors to buy bonds before cuts commence than to wait until cut cycles are underway.



Source: Bloomberg, as of August 5, 2024

In other words, foregoing some marginal yield pickup in money market-like investments today could position investors opting to extend duration now well for the rate cut cycle ahead.

Addressing Uncertainty

Separate of short-term interest rates, many clients today are concerned about equity market valuations, geopolitical turmoil, and election-year markets. While cash is a tempting place to park funds in periods of uncertainty, we note that the predictable income stream and total returns presented by bonds have historically smoothed returns and provided balance against more volatile assets such as equities.

Fixed income investing has been difficult in recent time periods due to pervasively low interest rates and total return opportunities. However, we find ourselves in a new environment where yields and creditworthiness of fixed income instruments appear quite attractive in the investment grade space for both taxable and tax-free bonds.

Without trying to time the market precisely, our team believes now is a great time to talk with clients about reallocating cash holdings to "lock it in."

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