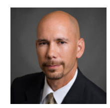
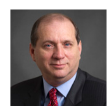
Stable Value Ready for a Higher Profile

Stable value primed for increased interest amid low rates.

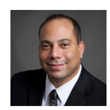
August 2021



Tony Luna
CFA, Head of Stable Value, Portfolio Manager



Robert Madore
Portfolio Manager, Stable Value



Whitney H. Reid
CFA, Fixed Income Portfolio Specialist

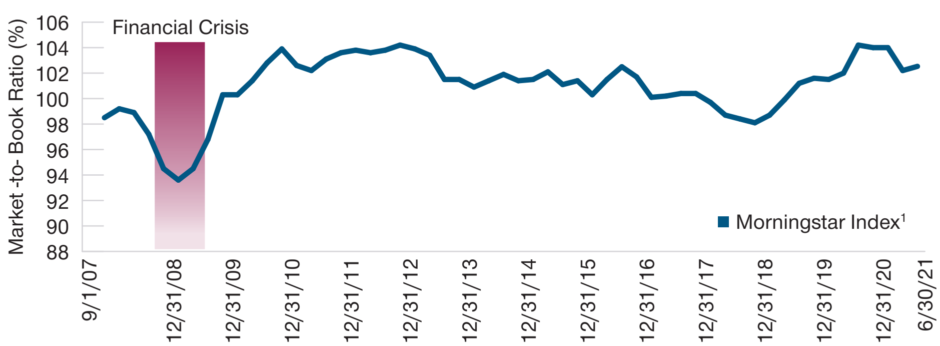
KEY INSIGHTS

- Stable value navigated the coronavirus pandemic-related market shocks, with assets growing markedly over the past 12 months.
- Relative to money market funds, we believe stable value products continue to maintain a significant yield advantage in this low interest rate environment.
- Even in a rising rate environment, stable value can be a compelling option in the principal preservation space.

Stable value products weathered the coronavirus pandemic and the global economic fallout remarkably well. In their first major adversity test since the 2008–2009 global financial crisis (GFC), stable

Historical Market-to-Book Ratios

(Fig. 1) Market-to-book ratios were stronger heading into the recent crisis



As of June 30, 2021.
Source: Morningstar. See Additional Disclosure.
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 GR USD from January 31, 2021, to the current period ending date.

[1] The Morningstar US CIT Stable Value GR USD (Morningstar SV CIT Universe) , formerly The Hueler Analytics Stable Value Pooled Fund Index is provided by Morningstar, Inc., a financial services firm, provides an array investment research and investment management services. The Morningstar SV CIT Universe is an equal-weighted total return average across all participating funds in the Universe and represents approximately 75% of the stable value pooled funds available to the marketplace.

value portfolio assets grew by more than 10% in the one-year period ended December 31, 2020, according to the Stable Value Investment Association. The wrap industry, which underwent reforms following the GFC, also proved resilient.

In the runup to the 2020 crisis, stable value funds were in a much better position, in terms of guidelines, crediting rates and market-to-book ratios, compared with 2008. As a result, market-to-book ratios held up much better following the pandemic relative to where they were after the GFC.

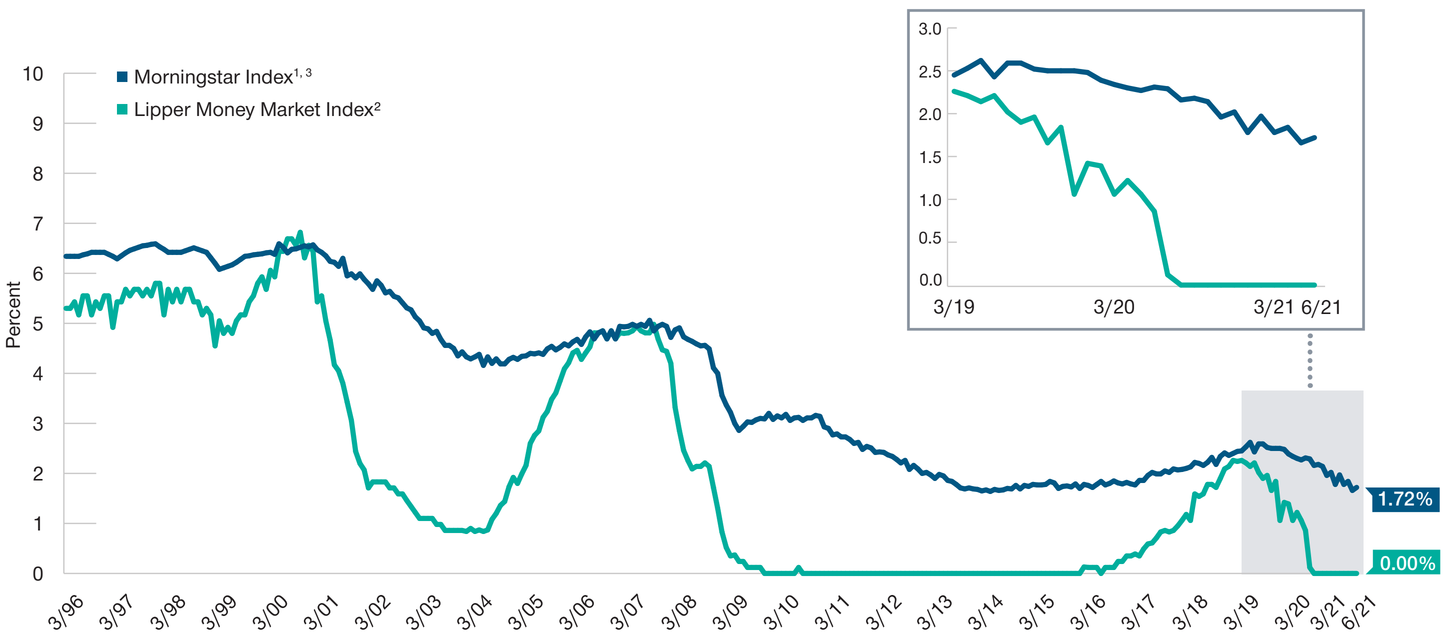
Low Rates Present Challenges for Money Market Yields

With the Federal Reserve maintaining its accommodation for the near term, stable value can potentially offer similar returns to short-term bond funds, likely outpacing money market funds. Stable value crediting rates have continued to outpace money market fund yields as the Fed has maintained short-term rates at near zero. Indeed, the current yield advantage is consistent with prior low rate environments over the past 20 years. Currently, stable value's yield premium over money market funds is at the higher end of its historical range.

Given the lack of yield in money market funds, stable value has experienced an increase in flows. With the Fed likely on hold through 2022 and the potential for a steeper yield curve, this trend could continue. Relative valuations, ample wrap capacity, money market reforms,

Annualized Yield Comparison

(Fig. 2) Stable value can offer a yield advantage to money markets



As of June 30, 2021.

Past performance is not a reliable indicator of future performance. Money market and stable value funds have different risks. It is important that you carefully review the legal documents for each type of vehicle prior to investment to determine if it is appropriate for you. Figures are calculated in U.S. dollars.

[1] Universe rates of return are reported gross of management fees.
Source for Morningstar index data: Please see Additional Disclosures for information about this Morningstar information.

[2] Source for Lipper Index Data: Lipper, Inc. Portions of the information contained in this display was supplied by Lipper, a Refinitiv Company, subject to the following: Copyright 2021 © Refinitiv. All rights reserved. Any copying, republication or redistribution of Lipper content is expressly prohibited without the prior written consent of Lipper. Lipper shall not be liable for any errors or delays in the content, or for any actions taken in reliance thereon.

[3] Morningstar data are as of June 30, 2021.
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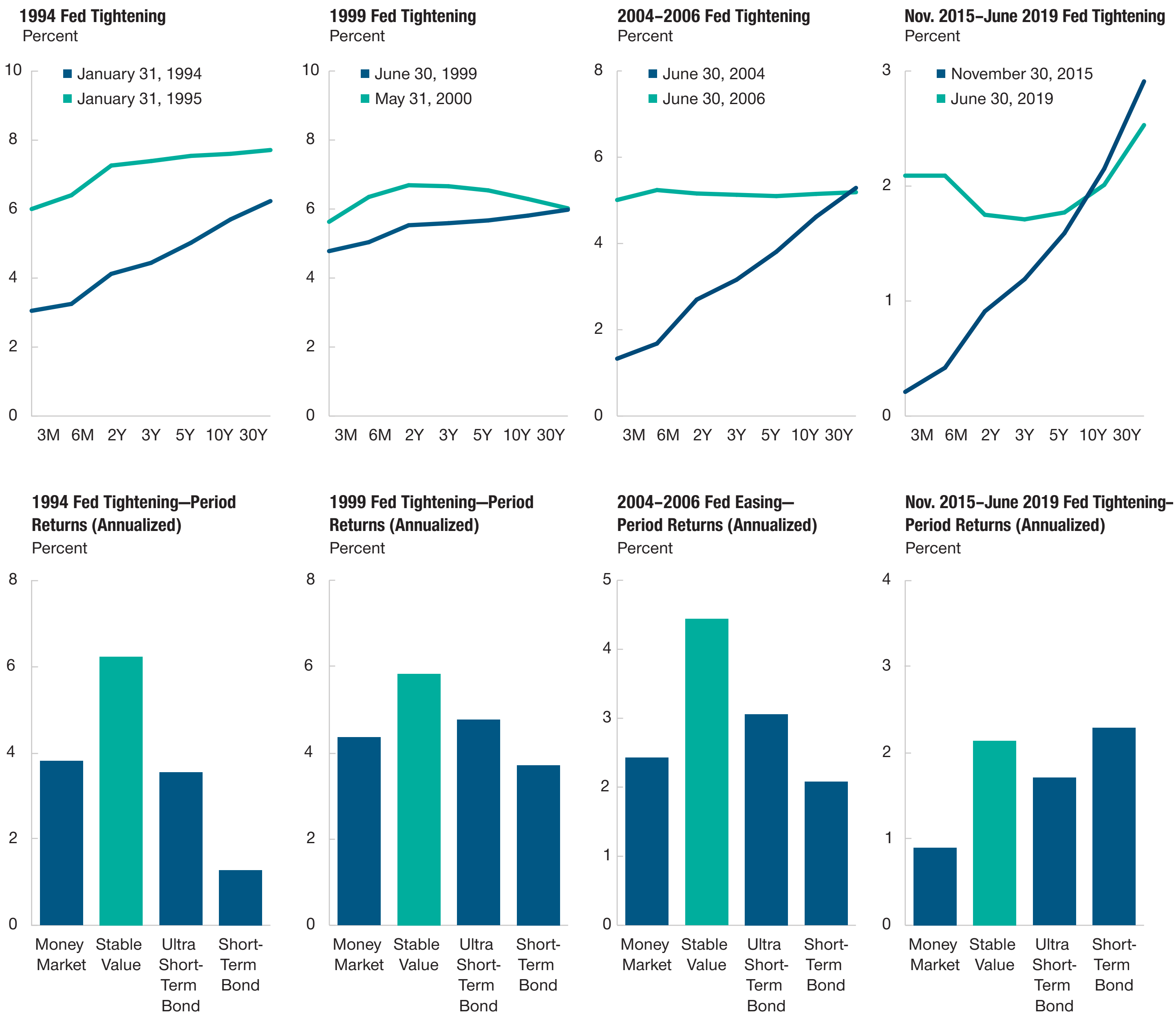
Historical Rate Hiking Cycle Yield Curve Change

(Fig. 3) Stable value has fared well in a rising rate environment



Past performance is not a reliable indicator of future performance.
Money market funds, trusts, separate accounts, and mutual funds 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 US Treasury Money Market Index; Ultra Short-Term Bond is represented by the Bloomberg Barclays 9–12 Month T-Bill Index; Short-Term Bond is represented by the Bloomberg Barclays U.S. 1–3 Year Government/Credit Bond Index; Stable Value is represented by the Morningstar US CIT Stable Value GR USD.
The Fed's target rate rose 300 bps over the 1994–1995 tightening cycle; 175 over the 1999–2000 tightening cycle; 425 bps over the 2004–2006 tightening cycle; and 250 bps over the current tightening cycle.
Sources: Morningstar, Lipper, Inc., U.S. Department of the Treasury, and T. Rowe Price.
Source for Bloomberg Barclays index data: Bloomberg Index Services Limited. Please see Additional Disclosures for information about this Bloomberg information.
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and litigation following the global financial crisis involving plan sponsors who did not offer a stable value option all combine to keep stable value an attractive option for plan sponsors.

Past Rising Rate Environments Display Stable Value's Potential

Despite the Fed's posture, markets have in recent months become more volatile amid increased inflation. While there is evidence that higher inflation readings are a result of the base effects from the coronavirus pandemic, market participants are clearly split regarding the endurance of inflation and whether rates will recede in the ensuing months. But the debate over inflation is certainly a highly relevant one, and investors may want to be mindful that in a rising rate environment, stable value can outperform low duration strategies like ultra short-term and short-term bond funds, as well as money market funds.

This combination of a relative yield advantage and potential outperformance in rising rate environments has helped to fuel continued inflows into the stable value asset class. Moreover, it has spurred greater interest and adoption of stable value by plan sponsors and other financial professionals.

Recent Changes Simplified Stable Value

In addition to potentially strong performance and flows, we continue to see product innovation in the stable value space as managers negotiate more flexible contract terms with wrap providers to increase usage and availability.

For example, several stable value funds have waived the 90-day equity wash provision for self-directed brokerage accounts. Moreover, several funds have reduced their competing fund definitions from three-year duration fixed income investment options down to a 2.5- and a 2-year fixed income investment option in order to streamline the use of stable value for plan participants.

In this period of strong market-to-book ratios, some funds have relaxed enforcement of exit provisions, commonly called put provisions, and permitted early payouts of account terminations.

Lastly, we continue to see stable value expand availability across recordkeeping platforms in addition to increased usage as a standalone investment option. The product is also more commonly featured as a building block in target retirement date products, other comingled products, and managed accounts.

Looking Ahead

With stable value an attractive principal preservation investment option relative to money market funds, plan sponsors are giving stable value a second look and considering adding stable value to their plan line-ups.

Stable value can be an attractive investment option for investors seeking principal preservation and liquidity. With some of the volatility and uncertainty surrounding the events of 2020 subsiding, many retirement investors could begin rotating back to riskier parts of the market.

The Fed, however, has been transparent about its trajectory for policy rates and willingness to let core inflation run above 2%. This environment could create more risk for longer maturity assets through a potentially steepening yield curve. A gradually rising rate environment, however, should support stable value products, which feature shorter duration profiles than many bond funds while investing in higher-quality securities. Stable value product offerings are more flexible and easier to implement than in years past. Greater flexibility has led to wider adoption, availability, and greater usage both as a standalone investment option and as a building block in other investment options like target date funds and managed accounts.

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