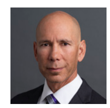
Impact of Rising Rates on Stable Value

Long-term opportunities remain despite headwinds.

February 2023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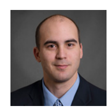
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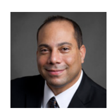
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KEY INSIGHTS

- Stable value has a long history of strong performance relative to money market funds.
- Infrequent, brief periods of moderate disintermediation, where money market funds outyield stable value funds, are nothing new, and the current period should revert to the historical normalcy over time.
- While higher rates lead to lower market-to-book value ratios, they also lead to higher reinvestment yields and more attractive crediting rates.

For investors looking for an investment option seeking principal preservation, stable value can offer shelter from market volatility while potentially providing stable income. Moreover, given its relatively longer duration and broader range of investments, stable value has historically offered a yield premium over money market funds, even in periods where the Federal Reserve (Fed) was hiking rates and yield curves were flattening. As highlighted in the following chart (Fig. 1), on a rolling monthly basis, stable value has provided, on average, 1.80% of excess return relative to money funds over the past 20 years. And while there were periods of disintermediation, where the Fed was tightening monetary policy and money fund yields exceeded stable value crediting rates, these periods were brief and were quickly followed by periods of easy monetary policies.

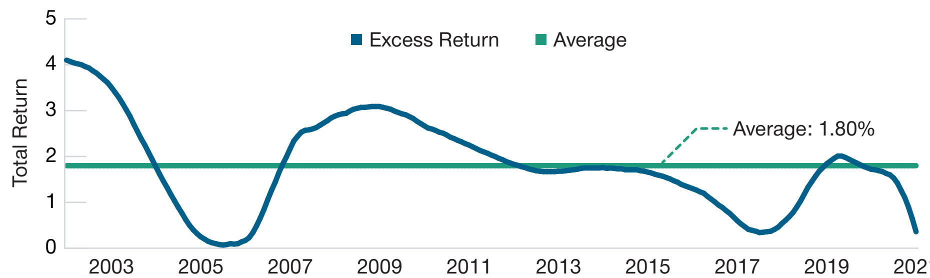
While we are currently in a period of disintermediation, we believe that stable value continues to be on firm footing with ample wrap capacity and solid relative long-term performance. That said, higher rates have led to weaker market-to-book value ratios, but more attractive reinvestment rates and rising crediting rates could be advantageous for stable value investors in the longer term. For reference, crediting rates are the book value yield that a stable value participant receives, and reinvestment rates represent the market value yield on the underlying fixed income portfolio in a stable value fund.

We Have Been Here Before

Over the past 30 years, stable value has typically provided a safe harbor with competitive yield for investors throughout two financial crises, in addition to two 0% interest rate

Stable Value Offers Yield Premium

(Fig. 1) Historically, stable value has provided a steady yield advantage over money markets



As of December 31, 2022.

Past performance is not a reliable indicator of future performance.

Sources: Lipper and Morningstar. Please see Additional Disclosures for more information.

The above represents one-year rolling monthly excess returns of the Morningstar US CIT Stable Value Index versus the Lipper Money Market Index. 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.

Figures are calculated using monthly data and are gross of fees. Returns would have been lower as the result of the deduction of applicable fees.

environments. While each financial crisis had unique volatility, credit, and liquidity challenges, rising interest rates provoke a host of new challenges ranging from weaker market-to-book value ratios and an uncertain period of disintermediation from money market funds.

However, infrequent periods of disintermediation are not new, as highlighted in Figure 2. Looking back at most periods of disintermediation, the amount was shallow, and the period of disintermediation was brief. The yield dynamics between money markets and stable value quickly reversed after the Fed started cutting rates to start supporting the economy.

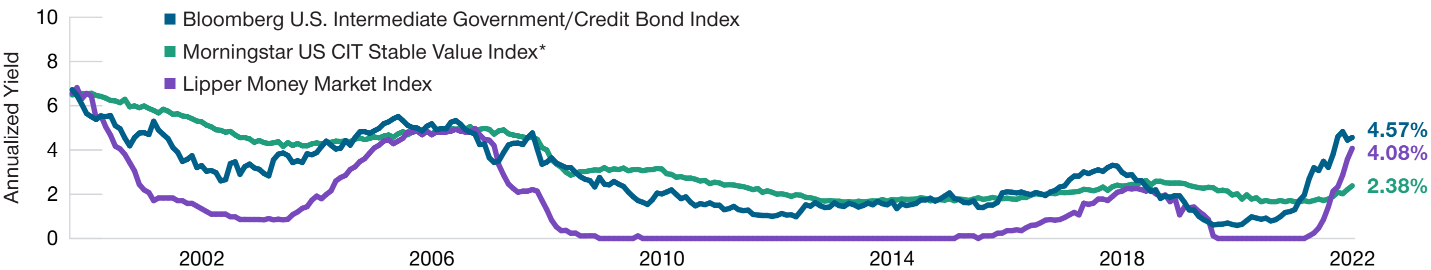
Rising Rates Present Both Challenges and Opportunities for Stable Value

As noted above, stable value has weathered periods of disintermediation before. However, we remain mindful that each market environment is unique. How the current environment differs from previous monetary tightening cycles is the extraordinary speed of rate hikes deployed by the Fed as it confronts stubborn inflation persisting at the highest level since 1980s. In response to the Fed's aggressive policy actions, shorter-term rates have taken the brunt of the impact with the three-month Treasury yield surging rapidly by more than 400 basis points over the course of 2022. As a result, the 2-/10-year portion of the yield curve has remained inverted.

On the other hand, rising rates may present an opportunity for plan sponsors who might be looking to convert a money market fund into stable value. As shown in Figure 2, the reinvestment yield for stable value as represented by the Bloomberg U.S. Intermediate Government/Credit Bond Index remains higher than the money market yield as represented by the Lipper Money Market Index. As long as the reinvestment yield for a new stable value investment exceeds the yield of the money market fund, participants should see an immediate benefit from a conversion.

Historical Crediting Rates and Money Fund Yields

(Fig. 2) Stable value maintained competitive yields over time



Data range September 30, 2000–December 31, 2022.

Past performance is not a reliable indicator of future performance.

Sources: Bloomberg, Lipper, and Morningstar. Please see Additional Disclosures for more information.

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.

*Universe rates of return are reported gross of management fees.

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 the current period ending date.

Conclusion

Each market environment is different, and this market with rising interest rates, higher inflation, and weaker market-to-book value ratios has its own unique challenges and opportunities. With a long history of strong performance, ample wrap capacity in the market, and higher reinvestment rates, stable value should remain an important investment option for participants looking for principal preservation and a competitive rate of income.

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