What's Next for Stable Value?

Stable value could benefit after the Fed stops hiking.

September 2023

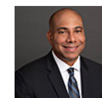
KEY INSIGHTS

- With the Fed telegraphing a modest amount of future rate hikes, we believe it is closer to the end of its rate hiking cycle.
- Though U.S. money market fund yields currently exceed stable value crediting rates, that relationship may begin to normalize as crediting rates move higher.
- Many plan consultants have stayed the course as crediting rates catch up with money market yields and market-to-book ratios move closer to par.

Antonio L. Luna, CFA
Head of Stable Value, Portfolio Manager

Xin Zhou, CFA, FRM
Portfolio Manager, Stable Value

Ben Gugliotta, CFA
Portfolio Manager, Stable Value



Whitney H. Reid, CFA
Portfolio Specialist, Stable Value

Over its nearly 50-year history, stable value has served as a relatively less volatile option for older U.S. retirement investors looking for stability while potentially providing attractive income. Moreover, given its longer duration, U.S. stable value has historically offered a yield premium over money market funds, even in periods where the U.S. Federal Reserve was hiking rates. When comparing the performance of the Morningstar US CIT Stable Value Index with the Lipper Money Market Index on a rolling monthly basis, stable value has provided, on average, 168 basis points of excess return relative to money funds over the past 20 years.

Stable Value Has Offered Advantages Over Its History

And while there have been periods of disintermediation, where the Fed was tightening monetary policy or hiking rates and money fund yields exceeded stable value crediting rates, these periods were brief and were quickly followed by periods of easy monetary policies. This hiking cycle has been different as the Fed has tightened rates quicker and more aggressively to control inflation, and stable value excess returns relative to money market funds turned negative for the first time in nearly 20 years. Looking at Figure 1, the Morningstar US CIT Stable Value Index has still outperformed the Lipper Money Market Index in 98% of monthly periods rolling annually up through the most recent quarter-end.

What's Next for Stable Value?

Over the past 20 years, stable value has weathered two financial crises and multiple 0% interest rate environments remarkably well. The industry now faces rapidly rising interest rates, higher inflation, and weaker participant cash flows—presenting a host of new challenges ranging from weaker market-to-book value ratios and extended periods of disintermediation from money market funds.

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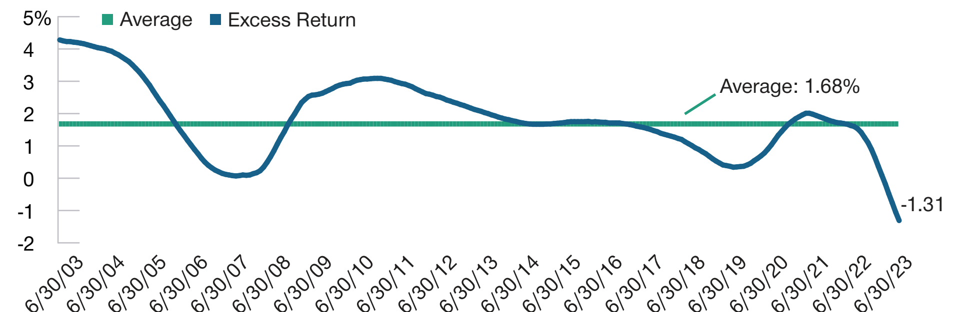
Stable Value Offers Yield Premium

(Fig.1) Stable value has looked attractive until recently



As of June 30, 2023.

Past performance is not a reliable indicator of future performance.

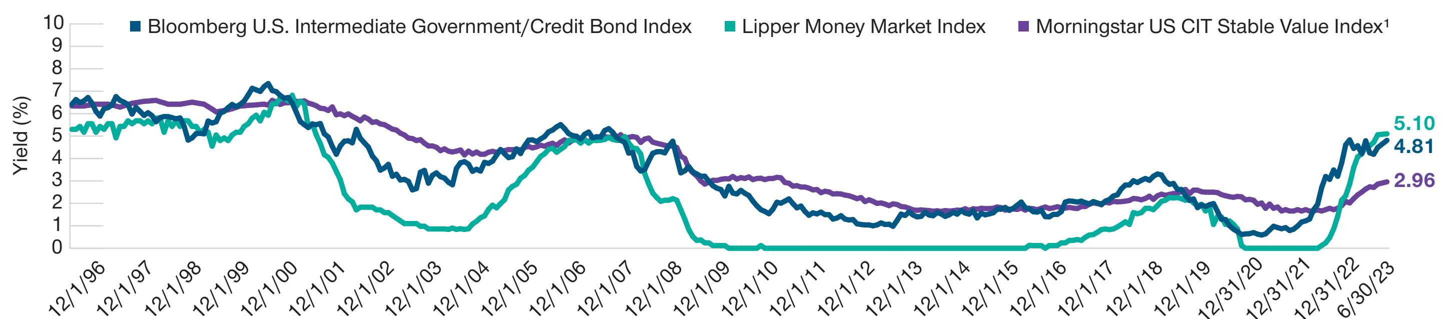
Money market funds and stable value products have different risks, including the possible loss of principal. It is important that you carefully review the legal documents for each type of vehicle to determine if it is appropriate for you prior to investment. Figures are calculated using monthly data and are gross of fees. Returns would have been lower as the result of the deduction of applicable fees. Source for Lipper data: Lipper Inc. Please see Additional Disclosures for information about this Lipper information. Source for Morningstar index data: Please see Additional Disclosures for information about this Morningstar information. The above represents one-year rolling monthly excess total returns of the Morningstar US CIT Stable Value Index versus the Lipper Money Market Index. 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.

As highlighted in Figure 2, while we have experienced past periods of disintermediation in prior rate hiking cycles, this period has been deeper and prolonged.

While stable value faces many challenges, the asset class continues to be on firm footing and should benefit from expanding wrap capacity and higher reinvestment rates, which ultimately supports higher crediting rates and improving market-to-book value ratios. Many U.S. consultants and advisors have chosen to stay the course with stable value over money market funds even as the Fed committed to tightening monetary policy.

Historical Crediting Rates and Money Market Fund Yields

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



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

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In the current environment where reinvestment rates exceed crediting rates, we would expect crediting rates to continue to move higher while money market fund yields peak with Fed fund rates. Eventually, crediting rates should catch and surpass money market fund yields, but it will take some time. That said, we believe this increase in stable value crediting rates could be accelerated once the Fed starts easing monetary policy.

Higher Rates Present Both Challenges and Opportunities for Stable Value

Higher interest rates present unique investment opportunities within the stable value asset class. While many advisors have chosen to remain in stable value over money market funds, some advisors have chosen to hold off on planned money market fund conversions in the face of rapidly rising rates. As such, we expect to see an uptick in U.S. money market fund conversions to stable value in the coming 12 months as advisors look to take advantage of potentially higher yields and more competitive stable value crediting rates.

In addition to money market fund conversions, we are also seeing an uptick in general account transitions, where plans are moving out of insurance general account and separate account products into stable value. We believe longer durations, weaker market-to-book value ratios, and crediting rates, along with onerous exit provisions and recent merger and acquisition activity, are driving some of this increased activity out of insurance products.

Conclusion

Even though stable value has struggled to keep pace with money market funds in this extraordinary period of rapidly rising rates, the asset class has held up well in the face of multiple headwinds. Moreover, wrap fees remain steady and wrap capacity continues to be robust and available as wrap providers remain open to deposits. Last, while higher rates present challenges, higher stable value reinvestment rates also present unique opportunities for money fund conversions and general account transitions to stable value separate accounts.

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