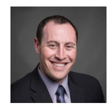
Help Your Clients Overcome the Opportunity Cost of Cash

Low duration fixed income may help improve outcomes.

June 2022

KEY INSIGHTS

- Many investors use bank deposits or money market funds to avoid drawdown risk. This may come at the opportunity cost of sacrificing potentially higher returns.
- Accepting a relatively small amount of volatility calibrated to an investor's liquidity needs may have a significant impact on returns.
- Low duration fixed income may help your clients improve outcomes for this lowest-risk portion of their portfolios.
- Your clients could potentially benefit from reinvesting in higher-yielding bonds, which may help offset bond price declines.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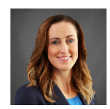
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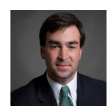
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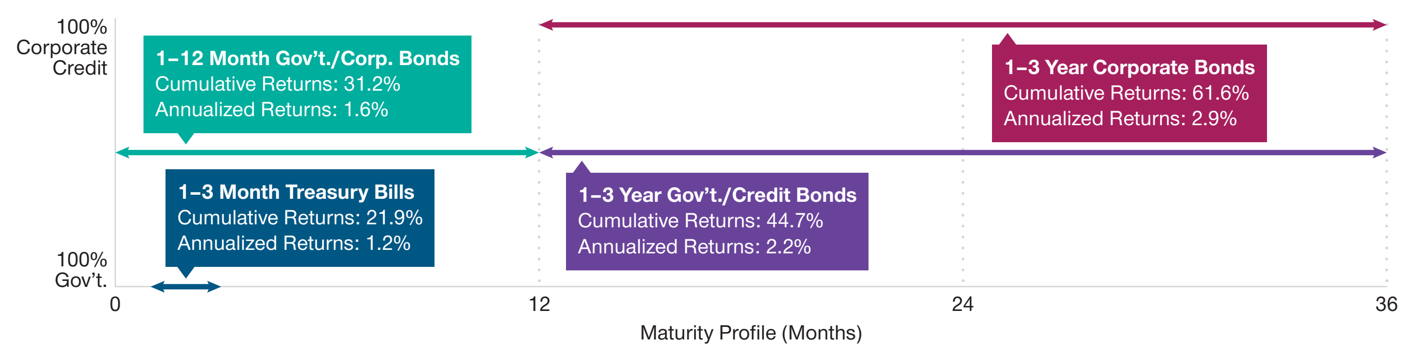
Your clients may be paying more for capital preservation than is needed

In today's 24/7 news cycle, filled with headlines about global recession risks, geopolitical turmoil, elevated inflation, and the Covid-19 pandemic, investment fears understandably have risen for many clients. So have cash balances. Money market fund assets have ballooned to over USD 4.5 trillion, up

Low Duration Assets Include a Range of Risk and Return Characteristics

(Fig. 1) Maturity profiles and historical returns for various market segments*



Past performance is not a reliable indicator of future performance.
Cumulative and annualized returns April 1, 2005, through March 31, 2022.
*Market segments based on the following indexes: 1–3 Month Treasury Bills = Bloomberg U.S. Treasury Bills 1–3 Months Total Return Index; 1–12 Month Government/Corporate Bonds = Bloomberg Short-Term Government/Corporate Index; 1–3 Year Government/Credit Bonds = Bloomberg 1–3 Year Government/Credit Index; 1–3 Year Corporate Bonds = Bloomberg 1–3 Year Corporate Index.
Source: Bloomberg Finance L.P. Data analysis by T. Rowe Price.

By accepting a modest increase in interest rate and/or credit risk, your clients may be able to enhance returns while still retaining a considerable degree of market liquidity.

from USD 3.0 trillion at the end of 2018.[1] Meanwhile, the U.S. Federal Reserve has begun raising interest rates, pushing bond prices lower and yields higher.

This volatile market environment may have prompted many clients to ask, "What should I do with my cash?" For many, the answer appears to be to move their balances into bank deposits, money market funds, or other short-term accounts with fixed nominal values, leaving them out of the market and on the sidelines.

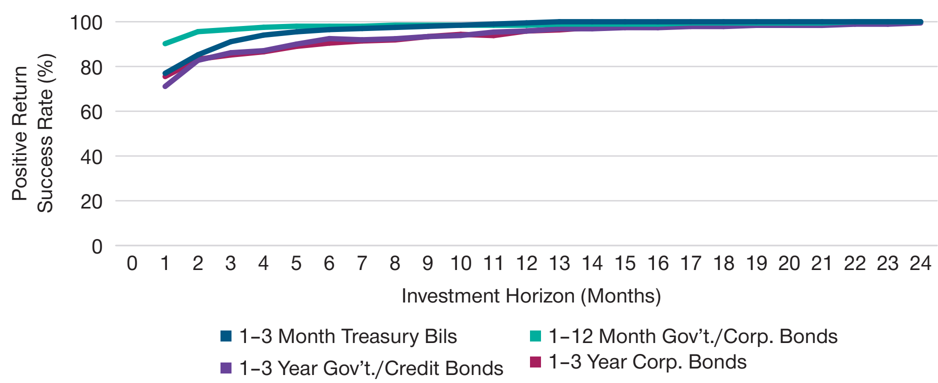
There are other answers, however. Most clients typically know in advance when they will need to access cash for larger expenses, such as home purchases or college tuition payments. In our view, this creates flexibility for these investors to consider allocating short-term balances to assets with greater return potential than bank deposits or money market funds, potentially enabling them to lower the opportunity costs of being "out of the market."

Fixed income markets include a variety of relatively low duration assets, such as short-term government or investment-grade corporate bonds. We believe these market segments can provide alternatives for your clients' shorter-term balances. By accepting a modest increase in interest rate and/or credit risk, your clients may be able to enhance returns while still retaining a considerable degree of market liquidity.

To assess the potential risks and benefits of low duration assets, we

When Aligned With Expected Cash Needs, Low Duration Assets Provided a High Degree of Capital Preservation

(Fig. 2) Positive return success rates over various time horizons*



	Positive Return Success Rate (%)*			
	One Month	Six Months	One Year	Two Years
1–3 Month Treasury Bills	77%	96%	99%	100%
1–12 Month Gov't./Corp. Bonds	90	98	98	100
1–3 Year Gov't./Credit Bonds	71	92	96	99
1–3 Year Corp. Bonds	75	90	96	100

April 1, 2005, through March 31, 2022.

Past performance is not a reliable indicator of future performance. Index performance is for illustrative purposes only and is not indicative of any specific investment. Investors cannot invest directly in an index.

*Over rolling time periods shown, rolled monthly. Market segments based on same indexes as Figure 1.
Source: Bloomberg Finance L.P. Data analysis by T. Rowe Price.

[1] Source: Investment Company Institute, as of March 31, 2022.

examined the historical performance of four specific low duration market segments over a 17-year period from April 1, 2005, through March 31, 2022 (Figure 1). We measured the annualized and cumulative returns for each market segment over that period and their success rates at delivering positive returns over rolling time periods ranging from one month to two years (Figure 2).[2]

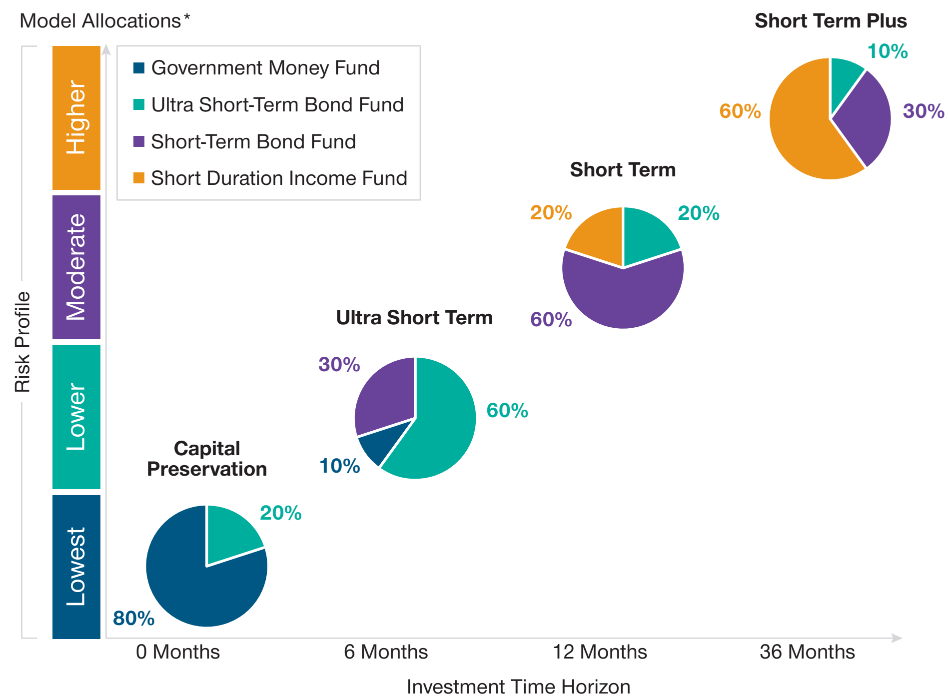
Not surprisingly, we found that the more interest rate exposure a hypothetical low duration investor was willing to take, the more likely they were historically to be compensated with higher returns. The question, then, becomes what level of risk exposure offers higher potential returns while still providing some measure of capital preservation?

In over 70% of the one-month periods we examined, each of the four low duration market segments produced positive returns. Moreover, as the investment horizon was increased, the frequency of positive cumulative returns trended toward 100%. At the two-year horizon, positive return success rates were at or near 100%; but even at the one-year horizon they were greater than 96%.

Based on our analysis, we conclude that investors who do not require immediate liquidity should consider accepting the risk of drawdowns, which we believe are likely to be slight, in the interim in exchange for potentially higher returns over time.

T. Rowe Price Low Duration Model Solutions

(Fig. 3) Seeking to do more with liquid short-term balances



*Strategic neutral weight allocations are shown above. Actual portfolio weights will vary with tactical asset allocation changes and market fluctuation. All allocation weights are subject to change without prior notice.
Source: T. Rowe Price.

[2] The positive success rate for each market segment was defined as the percentage of total returns for the relevant index that exceeded 0.0% in all rolling periods examined over time horizons ranging from 1 to 24 months.

> We believe that by blending actively managed strategies for various market segments, investment professionals may be able to achieve better outcomes for their clients....

T. Rowe Price's Low Duration Model Portfolios offer experienced portfolio managers, thoughtful strategic designs, and tactical asset allocation expertise in one package.

To help you answer the question when clients ask what they should do with their cash, T. Rowe Price has developed a set of Low Duration Model Portfolios designed to align investors' expected cash flow needs with defined time horizons (Figure 3). T. Rowe Price has used this same process to manage cash on the firm's balance sheet since 2018.

Our Low Duration Model Portfolios seek to provide income over targeted investment horizons ranging from six to 36 months. We believe that by blending actively managed strategies for various market segments, investment professionals may be able to achieve better outcomes for their clients than are reflected in the index performance data used in this analysis. We believe these models offer the opportunity to reduce the cash drag of a portfolio, without overly relying on duration and below investment-grade credit risk often embedded in other yield-enhancing options.

We believe our model portfolios and related services can serve as "force multipliers" that will make it easier for you to offer well-resourced, institutional-quality investment solutions while leaving you more time to spend with clients and grow your practice. Our financial intermediary specialists would be happy to provide additional information on T. Rowe Price model portfolio services upon request.

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T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

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Past performance is not a reliable indicator of future performance. All investments are subject to market risk, including the possible loss of principal. All charts and tables are shown for illustrative purposes only.

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Consider the investment objectives, risks, and charges and expenses of the T. Rowe Price mutual funds carefully before investing. For a prospectus or, if available, a summary prospectus containing this and other information, visit www.troweprice.com. Read it carefully.

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