Morley **Insights**

Morley
Capital Management

Capital preservation: rising interest rates - flattening yield curve

Interest rates continue to rise, though the longer end of the yield curve is rising more slowly than the short end, creating a flatter yield curve than normal. Some market watchers expect the curve to invert as rates continue to rise. Stable value investors are asking: How will stable value perform relative to money market funds in this rising rate environment and a flattening or inverting yield curve?

What we'll discuss

- **Stable value performance relative to money market funds in a rising rate and flattening yield curve environment**
- **The benefit of stable value funds over money market funds**

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To answer this question, let's see what history tells us, particularly time periods where the yield curve has been flat or inverted.

Stable value crediting rates generally follow the course of interest rates. The average duration of stable value is typically longer than money market so stable value crediting rates will respond to interest rate movements somewhat more slowly than money market rates.

Yield curves usually have a positive slope, meaning investors typically consider longer duration assets to be riskier than short duration assets and therefore require higher yields to invest in longer duration assets. When a yield curve has flattened or inverted, it has generally forecasted a softening or slowing economy that may result in a recession. Historically, these slope changes are not long lasting.

How does stable value perform when the curve is flat or inverted?

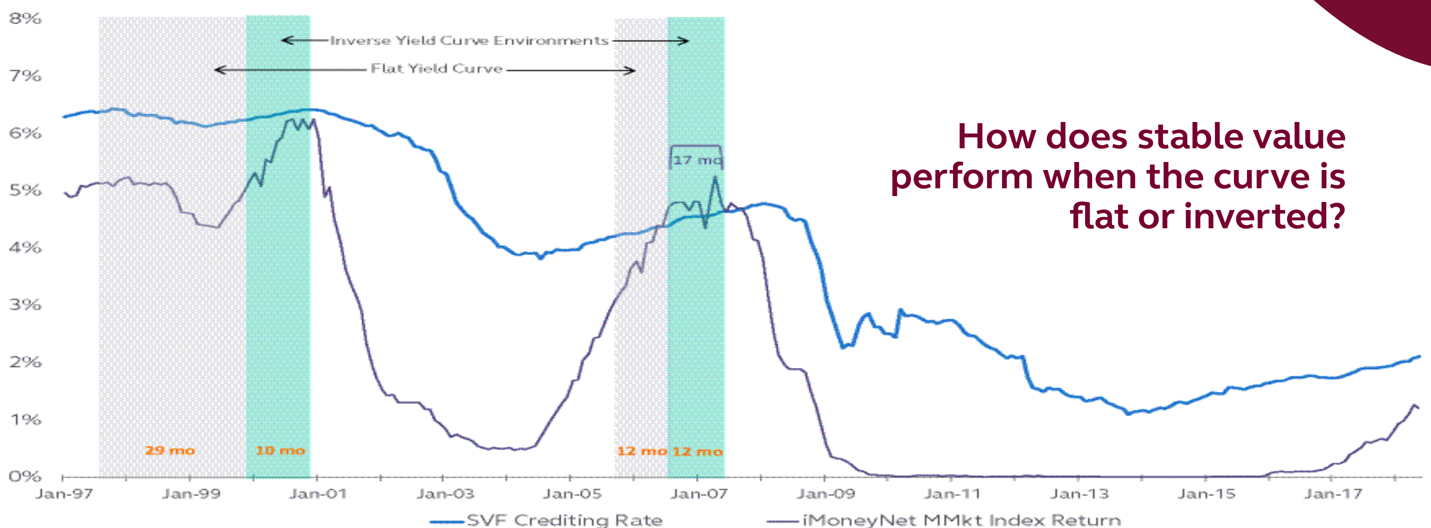

Figure 1

History tells us that stable value crediting rates have continued to provide a return premium over money market fund rates in flat yield curve environments. Over the last 20 years, as evidenced in Figure 1, there has only been one occasion where money market rates were higher than stable value crediting rates. This was during a yield curve inversion, where short duration yields were higher than longer duration yields.

What is the benefit of longer duration stable value funds over short duration money market funds?

The performance benefit of managing stable value to a longer duration target is observed through measuring the efficient frontier of portfolio returns. At the participant level, returns can be improved by replacing money market with stable value as the capital preservation option[1]. At the managed account or custom target date level, stable value could provide a risk/return benefit that enhances the value of retirement savings without adding risk.

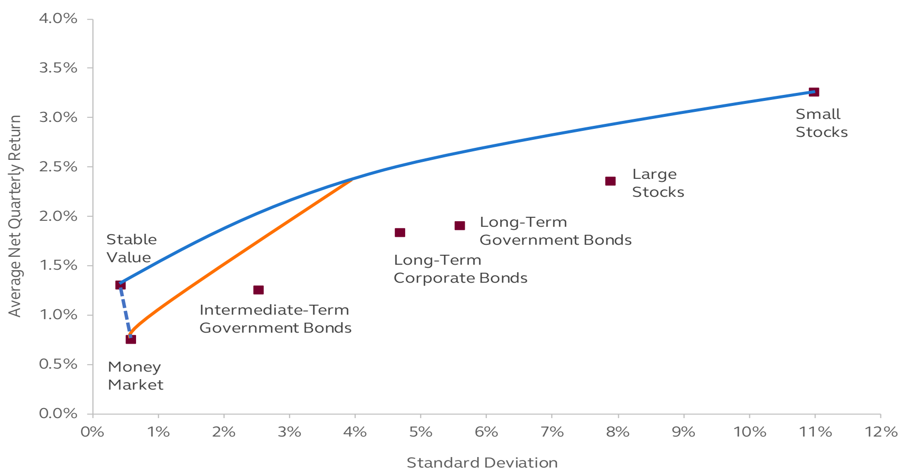

Figure 2. Efficient Frontiers for Alternative Asset Classes (Q4-1988 -- Q4-2015).

[1] MDPI and ACS Style
Babbel, D.F.; Herce, M.A. Stable Value Funds Performance. Risks 2018, 6, 12.

The Bottom Line

History tells us that interest rates will rise and fall and the yield curve will not always be positively sloped. It also tells us that the periods when the curve is flat or inverted are short-lived (Figure 1). History tells us that over time, stable value provides superior returns over money market even though money market rates may temporarily exceed stable value crediting rates. Finally, participants benefit from stable value over money market as a capital preservation option (Figure 2) or within managed accounts and target date funds by achieving higher returns without additional risk, enhancing their retirement savings.

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Performance (as of 6/30/19)	3 Month	YTD	1 Year	3 Years	5 Years	10 years
Morley Stable Value Fund Gross	0.60%	1.20%	2.33%	2.03%	1.83%	1.90%
iMoneyNet All Taxable	0.50%	1.00%	1.85%	1.01%	0.62%	0.32%

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