

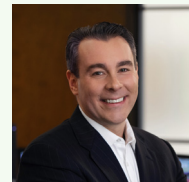
CASH IS NOT ALWAYS KING

As interest rates have risen from the latest Fed tightening cycle, many investors have elected to seek shelter from the volatility by investing in short-term vehicles like money market funds or T-bills. While it might appear tactically attractive, investors open themselves up to new risks by using short-term investments as a core part of their fixed income allocation.

Not only does favoring short-term investments like money markets or T-bills open investors up to significant reinvestment risk, but this strategy also historically underperforms when compared to owning intermediate municipal and taxable bonds after the peak of Fed tightening cycles.

MUNICIPAL BONDS

Using the Bloomberg 10-Year Municipal Bond Index as a benchmark, **Figure 1** shows how it played out for municipal bond investors:



CHRISTOPHER IOVANNA, CFA

*Vice President
Taxable Bond Client
Portfolio Manager*

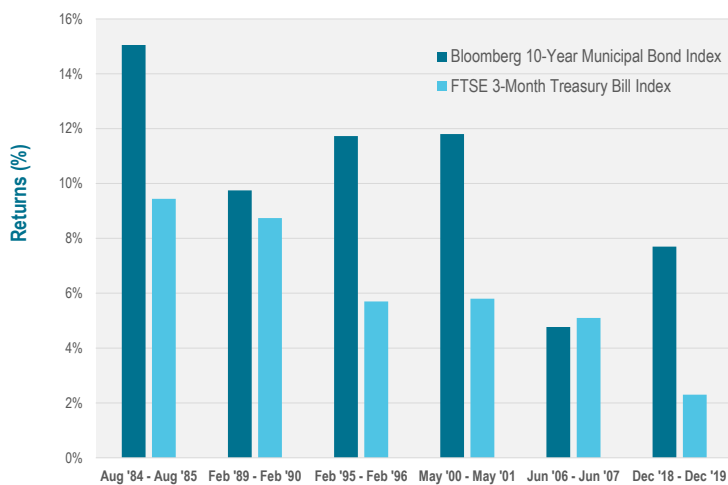


MICHAEL RABUFFO, CFA

*Principal
Municipal Bond Client
Portfolio Manager*

FIGURE 1

1-Year Returns Post Fed Tightening Cycles



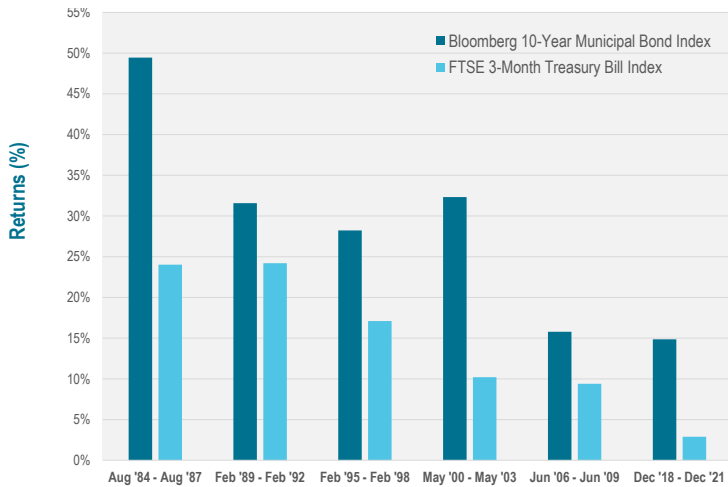
Sources: GW&K Investment Management, Federal Reserve, Bloomberg, and FactSet.
Returns represent 1-year cumulative returns after the Federal Reserve's final rate hike and are calculated monthly.

When compared to short-term instruments, intermediate municipals have outperformed in all but one of the years following the last six Fed tightening cycles. When you consider the added tax benefits, municipals outperformed quite handily, and the results were not particularly close.

As it relates to the three years following Fed tightening cycles, the risk of moving to cash is further magnified. Municipals cumulatively outperformed cash alternatives by approximately **14% on average (Figure 2)**.

FIGURE 2

3-Year Returns Post Fed Tightening Cycles



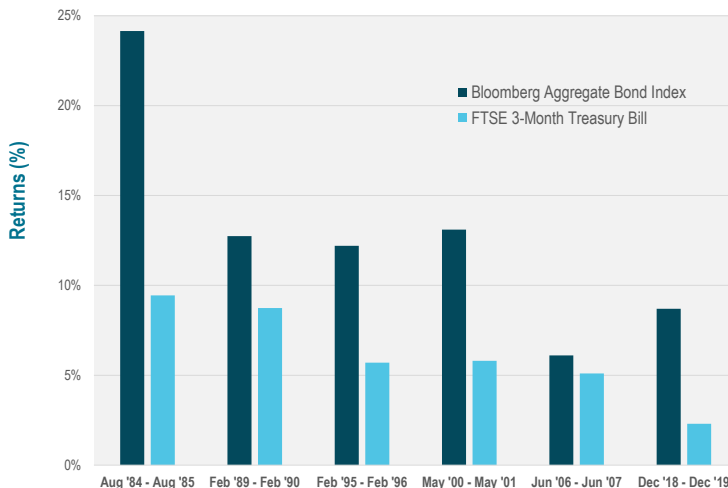
Sources: GW&K Investment Management, Federal Reserve, Bloomberg, and FactSet. Returns represent 3-year cumulative returns after the Federal Reserve's final rate hike and are calculated monthly.

TAXABLE BONDS

Now, looking at the Bloomberg Aggregate Bond Index as a proxy for taxable bonds (**Figure 3**), the story is quite similar:

FIGURE 3

1-Year Returns Post Fed Tightening Cycles



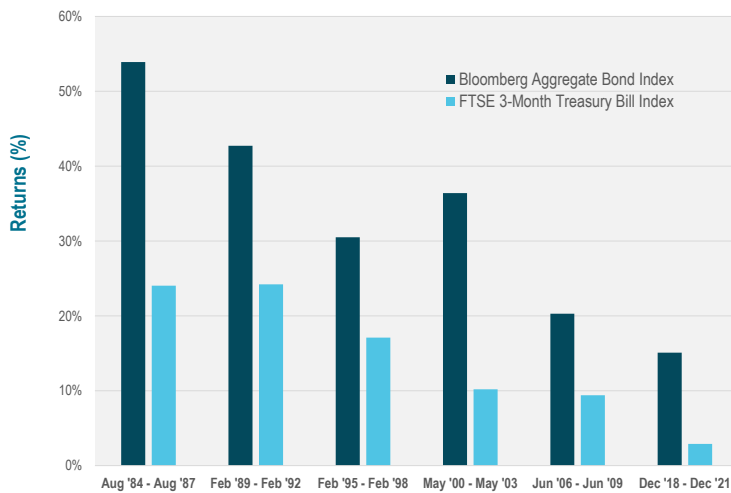
Sources: GW&K Investment Management, Federal Reserve, Bloomberg, and FactSet. Returns represent 1-year cumulative returns after the Federal Reserve's final rate hike and are calculated monthly.

In the 12 months following each of the previous six Fed tightening cycles, the Index outperformed cash alternatives by more than 6% on average.

As for three years following a Fed tightening cycle, the strategy of adding duration and forgoing cash alternatives paid off in spades, with the Index outperforming cash alternatives by more than **18% on average (Figure 4)**.

FIGURE 4

3-Year Returns Post Fed Tightening Cycles



Sources: GW&K Investment Management, Federal Reserve, Bloomberg, and FactSet. Returns represent 3-year cumulative returns after the Federal Reserve's final rate hike and are calculated monthly.

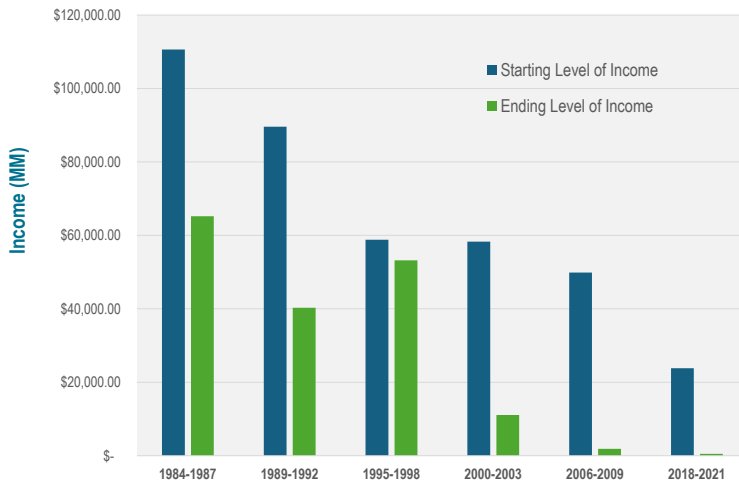
VOLATILITY IN MONEY MARKETS

Conventional wisdom suggests that money market funds generally exhibit minimal to no volatility. However, when a Fed tightening cycle turns into a Fed cutting cycle, money market funds are impacted materially.

Using the FTSE 3-Month T-Bill Index as a representation for money market funds, looking at the three years following the previous six Fed tightening cycles, the income generated by money market funds was 63% lower on average. Even with eliminating the Great Financial Crisis and the Covid-19 pandemic — during which, the Fed essentially cut its target rate to 0% — the income generated was still 46% lower on average (**Figure 5**).

FIGURE 5

Income Generated by FTSE 3-Month T-Bill Index on \$1 Million Over Three Years



Sources: GW&K Investment Management and FactSet.

IN CONCLUSION

Moving to cash in the face of increased volatility in fixed income markets and a Fed tightening cycle might feel like the right thing to do, but historically it has not been a winning strategy. A consultation with an active bond manager may be beneficial for investors who have questions about their fixed income allocations.

Follow the links to learn more about GW&K’s expertise in [municipal](#) and [taxable](#) bond management.

DISCLOSURES:

Sources for indexes and other external data include Bloomberg, Federal Reserve, and FactSet. The Bloomberg Aggregate Bond Index covers the US investment grade fixed rate bond market. It is comprised of securities from Bloomberg Government/Corporate Bond Index, the Mortgage-Backed Securities Index and the Asset-Backed Securities Index. The Bloomberg 10-Year Municipal Bond Index is composed of investment grade municipal bonds with a minimum credit rating of Baa. The FTSE 3-Month U.S. Treasury Bill Index, an unmanaged index, represents the performance of three-month Treasury bills. All material has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy of, nor liability for, decisions based on such information. This represents the views and opinions of GW&K and does not constitute investment advice, nor should it be considered predictive of any future market performance. The comments should not be construed as a recommendation of individual holdings or market sectors, but as an illustration of broader themes.

Past performance is no guarantee of future results.

www.gwkinvest.com

Boston Headquarters
 222 Berkeley Street
 Boston, Massachusetts 02116
 617.236.8900

Other Locations
 New York, New York
 Winter Park, Florida