Four Things to Consider When Moving out of Cash

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With so much uncertainty about when rate cuts will happen and to what extent, it's prudent to think about when to move your clients off the sidelines and participate more in the market. Here are a few things to consider when thinking about extending duration.

1. Historically, when the Fed cuts rates, it often does so quickly.

Over the past 30+ years, only once has the Fed cut rates by less than 100 bps in the first year of a cycle. And the one time they didn't was in a 'soft landing' environment.

While there's no way to predict how quickly cuts will come, the Fed has historically cut rates swiftly.

Fed Rate Cuts

Timeframe	Policy rate at first cut (%)	Rate cut (bps)	Duration of cycle (yrs)	Annualized cut pace (bps)	Cuts in first year (bps)
1989-1992	9.75	675	3.3	208	175
1995-1996*	6.00	75	0.5	150	75
2000-2003	6.50	550	2.5	220	475
2007-2008	5.25	500	1.3	400	375
2019-2020	2.50	225	0.8	300	225

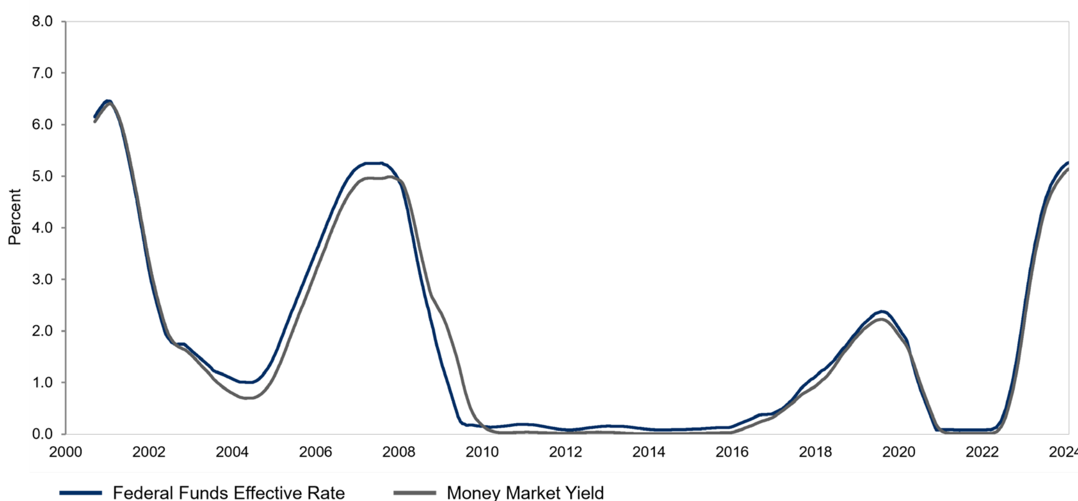
**Denotes "soft landing" cuts, i.e., no recession recorded*

Source Bloomberg LP, Wells Fargo Macro Strategy

2. If the Fed cuts rates, cash and equivalent investments are likely to see a decline in yields.

Historically, cash-equivalent investments - such as money market funds - have been closely correlated to the fed funds rate. If the Fed cuts rates, cash yields may follow a similar path.

Historically, Money Market Yields Have Been Closely Correlated to the Fed Funds Rate

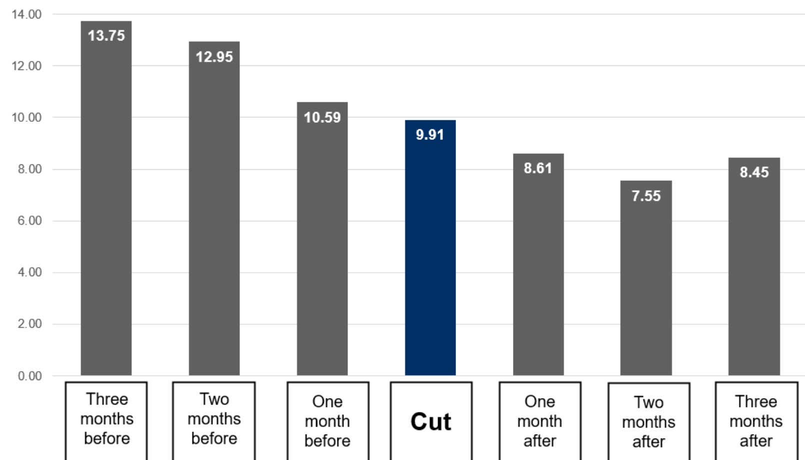


Source: Federal Reserve Economic Data and Morningstar. Data as of 12.31.2023. Money Market Yield reflects the Morningstar US Fund Prime Money Market 7-Day Yield, peer group median

3. Timing the market is hard. Historically, investors have been rewarded for being *early*.

Market forecasters have spent a great deal of energy trying to predict precisely when the Fed will cut rates, how much they will cut, and how long the cutting cycle will last. The truth is, the Fed is reacting to constantly changing data – so it's almost impossible to predict exactly what they will do.

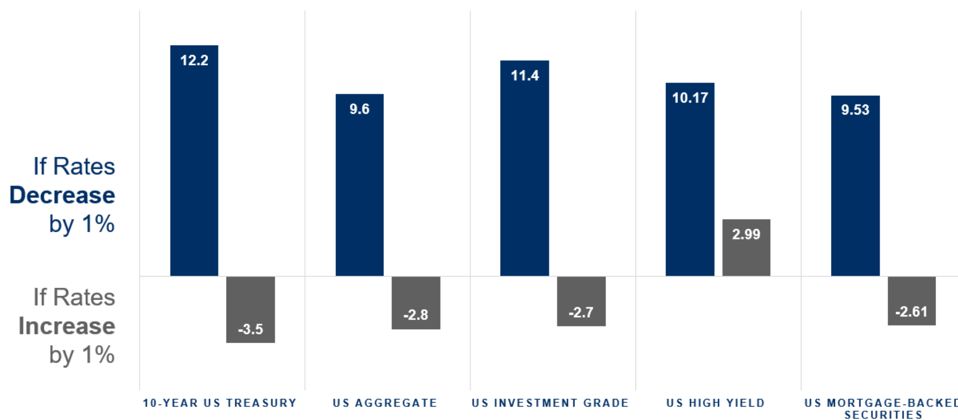
Instead of trying to time the market, investors have been well-served to act early. Historically, in the three months leading up to the first cut of a cycle, the yield on the 10-year Treasury fell an average of 90 basis points. So, investors have been rewarded for shifting out of cash-related investments and into high-quality bonds *before* the first cut.



Source: Morningstar. Data as of December 31, 2023. Average is based on the following dates of first Fed rate cuts: September 20, 1984; June 7, 1989; July 6, 1995; January 3, 2001; September 18, 2007; and August 1, 2019.

4. If the Fed defies expectations and increases rates, bond investors have cushion.

While extending duration via a diversified bond fund can have a positive impact on an investor's total return in a falling-rate environment – what happens if unexpected circumstances prompt the Fed to raise rates? If that happens, today's higher base rates mean that bonds can absorb some of the downside.



Source: Bloomberg. Data as of 01.31.2024.

To sum it up, investors should focus less on trying to predict the precise timing of Fed actions. History has shown that it is indeed better to extend duration ahead of a falling-rate environment, and that being late can result in missing out on returns.

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