



MAKE YOUR MONEY
MOVE

ERIK L. KNUTZEN, CFA, CAIA

Chief Investment Officer—Multi-Asset

REBEKAH McMILLAN, CFA

Associate Portfolio Manager—Multi-Asset

SHANNON L. SACCOIA, CFA

Chief Investment Officer—Private Wealth

Cash Balances: Is It Time to Make Your Money Move?

Investors moved large amounts of assets into money market funds during 2023.

Many were looking for safety and certainty after the equity and bond sell-off of 2022. Some were reassessing their long-term asset allocations in the new, higher-yielding environment. All were paid to be patient with a high cash rate that has been ahead of inflation for 10 months.

As short-term rates peak, however, we believe the opportunity costs of holding excess cash are growing. Investors may intend to return to the asset allocation they had before 2022 or ease back into a more fixed income-oriented, higher-yielding long-term allocation; either way, we believe it is time to make that money move.

Here we consider ways to put cash to work in a range of markets, recognizing that cautious investors may still seek the reassurance provided by assets generating income, and may be looking to target low volatility assets that can diversify risk as they reintroduce it to portfolios.

According to the fund-flows data provider EPFR, almost \$1.3tn flowed into U.S. money market funds during 2023. At almost \$6tn, U.S. money market fund assets are at an all-time high.

For much of the past 15 years, cash was a far from attractive investment. From the start of 2009 to the end of 2017, the cumulative—not annualized—return to U.S. dollar cash was less than 2.5%. We believe the picture is not much better over the very long term.¹

However, the last two years have reminded us that cash sometimes does generate an attractive short-term return. As policy rates have risen to 5%-plus, the cumulative dollar cash return through 2022 and 2023 was around 7.5%.² Investors were being paid to be patient: if they had excess cash, there was no hurry to return to long-term asset allocations.

But is that sustainable? Some investors may already regret not being fully reinvested in equity markets last year. We think this year will start to see bond market returns compete more strongly with cash, too.

Today's cash rates can make it all too easy to keep waiting for a "better moment" to move back to long-term asset allocations. But with the rate cuts now projected and \$6tn of cash waiting on the sidelines, we think the potential costs of being late to invest get higher with each passing day.

In our view, investors face three big questions:

- Does cash remain more attractive than locking in bond yields?
- Might it pay to wait before making new equity market allocations?
- If not, where might excess cash be deployed?

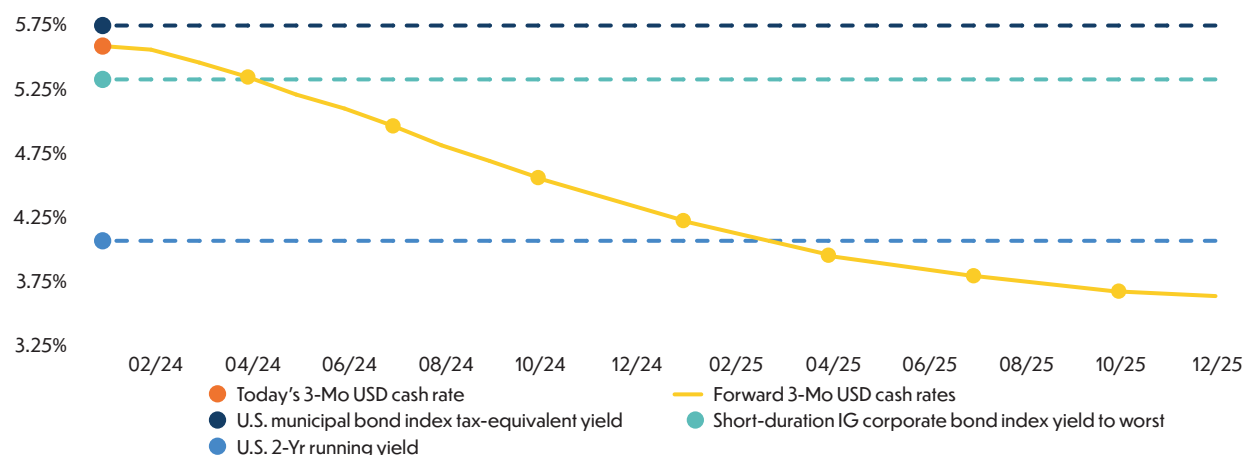
Does cash remain more attractive than locking in bond yields?

Today's cash rate is considerably higher than the yields on U.S. Treasuries or municipal bonds. It is even slightly higher than the yield of the average short-duration investment-grade corporate bond.

But market participants think cash rates are on their way down, from more than 5.5% today to more like 4% in a year's time. In comparison, investing in longer duration bonds today offers the opportunity to enjoy that yield until the bonds mature.

FIGURE 1. CASH IS UNLIKELY TO OFFER TODAY'S RATE FOREVER

Forward three-month USD cash rates versus bond market yields



Source: Refinitiv, Neuberger Berman. Data as of February 5, 2024. Short-duration IG corporate bond index is the ICE BofA 1-3 Year U.S. Corporate Index. U.S. municipal bond index is the ICE BofA U.S. Municipal Securities Index. Tax equivalent yield is for an investor in the highest federal U.S. tax bracket. Current yield of the U.S. two-year Treasury is the coupon rate divided by the current bid price.

¹ Since 1900, Treasury Bills have generated 3.4% per annum—only just ahead of inflation at 2.9%. U.S. equities have done much better, returning around 9.5% per annum. Bonds returned around 4.7% per annum. See the Credit Suisse Global Investment Returns Yearbook 2023, at <https://www.credit-suisse.com/about-us-news/en/articles/news-and-expertise/global-investment-returns-yearbook-2023-202302.html>

² Solactive Overnight USD Cash Index. Source: Refinitiv.

Even in two-year U.S. Treasuries, we believe there is now value in locking in bond coupons—and we see still more value in locking in yields in the intermediate, four- to six-year part of the curve.

The relative value case looks still stronger in U.S. municipal bonds, in our view, once tax advantages are taken into account. And cash also has a smaller head start over the yield of short-duration investment grade corporate bonds. Investors are right to ask whether a growth slowdown would put corporate bond repayments at risk—but investment grade defaults have been extremely rare and almost always more than compensated at the market level by the credit spreads, even when they have been at today's relatively tight levels.³

Unless cash rates decline much more slowly than the market currently anticipates, or short-duration investment-grade defaults rise substantially, we think bonds now look more attractive next to cash. In addition, at inflection points such as these, we believe active management of a fixed income portfolio can benefit investors, as taking more or less risk at various points on the yield curve and across the credit spectrum are important levers in periods of transition.

Might it pay to wait before making new equity market allocations?

When cash is paying 5.5% and equity valuations are quite high, it is very tempting to wait for a market "correction." However, as the well-worn saying puts it, "Investing is about time in the market, not timing the market."

Over the long term, equity markets have tended to climb steadily, punctuated by sometimes deep and sharp declines. For example, the losses in the very worst months in the S&P 500 Index's history have been markedly bigger than the gains in the very best months, but overall, our research finds that there have been around 50% more positive months than negative months. The comparative rarity and sharpness of sell-offs is what makes them difficult to predict, and that is one reason why equity investors have generally been paid a premium to stay invested.

Thinking long-term, therefore, it is very difficult in our view to justify holding cash rather than equity unless you believe that the economy is likely to stagnate indefinitely, or that valuations are so high that the equity premium has fallen to zero.

That said, the combination of a strong equity market recovery and economic uncertainty makes it difficult to shake concerns about potentially big losses over the nearer term.

Many investors consider today's S&P 500 Index valuation multiple, 19 times, to be high, making new investments risky. However, over the past 25 years, when the S&P 500 Index multiple was between 18 and 20 times, the average subsequent one-year excess return over cash was 4.7%; the worst one-year loss was -22.4%, but the best one-year gain was 35.3%. The highest ever multiple, 28.3 times in March 1998, was followed by a one-year excess return of 16.5%.

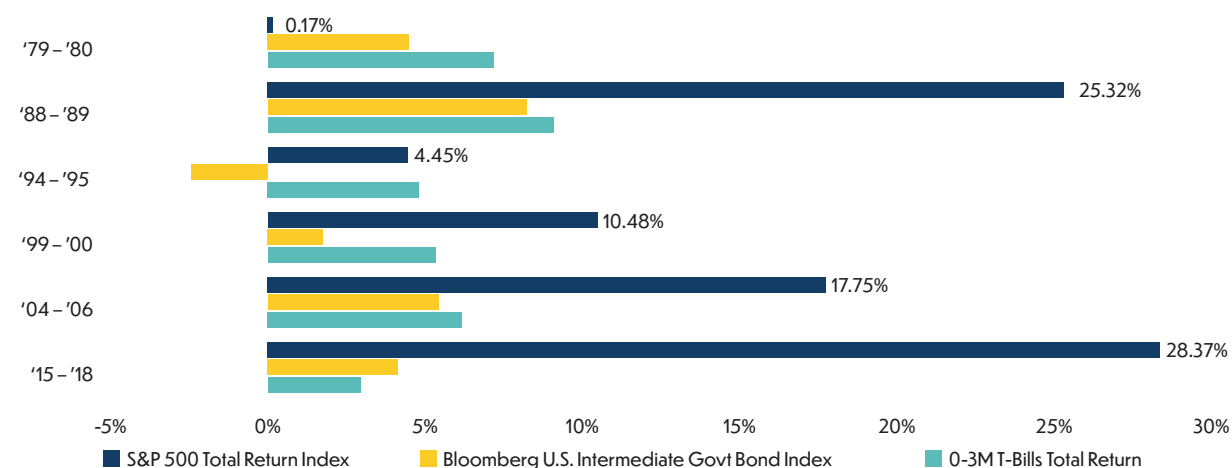
High valuations can be a sign of an overstretched market, but they can also be a sign of booming business: even if the forward earnings multiple peaks when you invest, if the earnings are realized and a rising price "normalizes" that multiple over the subsequent year, your return would be positive. As 2023 showed, it can be very difficult to tell what high valuations are telling us—but you can take off some of the pressure to be right by avoiding concentration in highly valued stocks and seeking out those at lower valuations.

Now let's look at where we are in the economic cycle. We use the U.S. policy rate as a proxy for that cycle, and look at the performance of the S&P 500 Index during periods when that rate has been rising and during the 12 months following the final hike of the cycle.

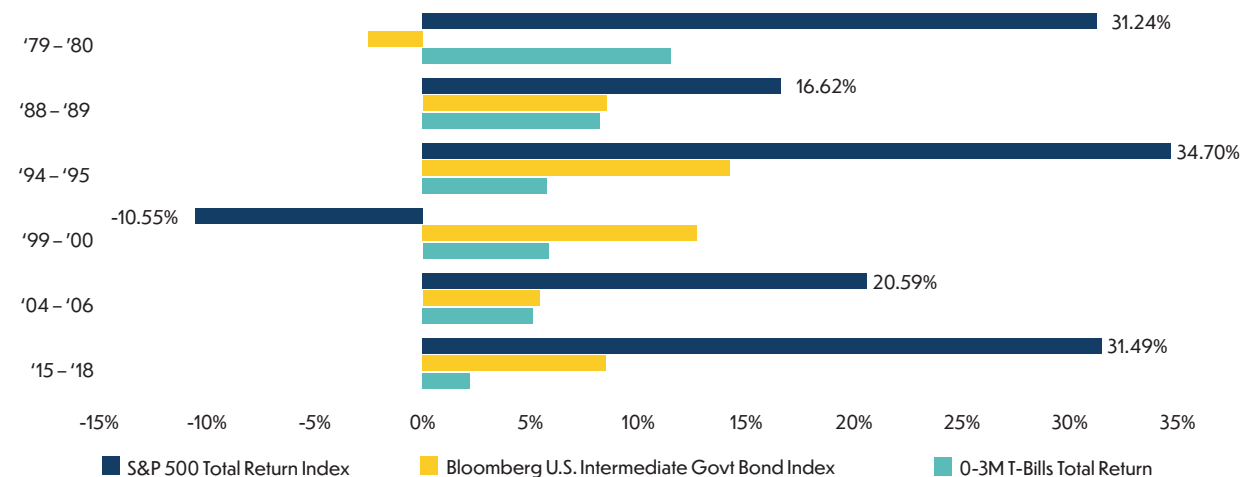
³ The option-adjusted spread of the ICE BofA 1-3 year U.S. Corporate Index was 73 basis points as of February 5, 2024. Since 1981 there have been only 88 investment grade defaults—and 38 of those occurred during the bursting of the dotcom bubble in 2002 and the financial crisis of 2008–9. Even in those years, the default rate was lower than 0.5%. For comparison, there have been 2,607 high yield defaults over the same period, and the average annual default rate has been 3.9%. See S&P Global, *Default, Transition, and Recovery: 2022 Annual Global Corporate Default and Rating Transition Study (April 2023)*.

FIGURE 2. EQUITIES HAVE HISTORICALLY PERFORMED WELL DURING AND AFTER RATE HIKES

Total returns during periods when the U.S. policy rate was rising



Total returns during the 12 months following the final raise of the U.S. policy rate

Source: Bloomberg, Neuberger Berman. Data as of December 31, 2023. **Past performance is not indicative of future results.**

Since 1979, the equity return has always been positive as rates have risen, and in four out of the six periods it strongly outperformed bonds and cash. The same has been true in the current cycle.

If rates have peaked, the historical data suggests to us that equities are likely to outperform over the next 12 months: since 1979, the only exception has been the 1999 – 2000 period that coincided with the bursting of the dotcom bubble.

To sum up, if it is difficult to tell what valuations are telling us about shorter-term return potential, and if peak rates suggest the next 12 months' equity returns could be positive and well ahead of cash or bonds, it becomes harder to justify holding cash rather than equity, in our view. All too often, with 2023 being perhaps the latest example, investors concerned about valuations or the economic cycle have found themselves missing out on the equity market's steady cumulative returns while waiting for a sell-off that never arrived.

Where might excess cash be deployed?

We assume that our investor remains relatively cautious, even as they are persuaded that a cash holding is no longer optimal. We think this investor is likely to have one or more of the following objectives:

1. **Generating income (with modest price volatility and/or diversifying characteristics)**
2. **Getting equity market exposure (with lower volatility)**
3. **Seeking diversifying risks**

GENERATING INCOME (with modest price volatility and/or diversifying characteristics)

Core Fixed Income: Short-Duration Credit and Municipal Bonds	<ul style="list-style-type: none"> · Credit spread and tax advantage over government bonds makes the yield more attractive relative to cash · Shorter maturities increase the correlation between starting yield and total return, lower price volatility, and make portfolios constantly “self-liquidating” and cash-generative
Extended Fixed Income: Flexible Fixed Income	<ul style="list-style-type: none"> · Active managers have the flexibility to allocate to different parts of fixed income curves (including short duration and cash) and different parts of the credit and liquidity spectrum, depending on evolving market conditions
Alternatives: Insurance-Linked Strategies	<ul style="list-style-type: none"> · Securitized reinsurance against natural catastrophe losses, such as catastrophe bonds, generates income with price volatility that diversifies against traditional financial risks · A shortage of risk capital in reinsurance has resulted in attractive yields · Short maturities increase the correlation between starting yield and total return, and make portfolios constantly “self-liquidating”

GETTING EQUITY MARKET EXPOSURE (with lower volatility)

Equity: Quality Equities	<ul style="list-style-type: none"> · Strong competitive positions, stable earnings, low leverage and high free cash flow are often associated with lower stock-price volatility · Sometimes large balance-sheet cash holdings can be paid out as dividends or stock buybacks, or used to generate (currently high) cash returns
Alternatives: Long-Biased Long/Short Equity Hedge Funds	<ul style="list-style-type: none"> · Price movements of short positions tend to offset partially those of long positions · These strategies earn (currently high) cash returns on derivative collateral
Alternatives: Collateralized Equity Index Put Writing (“PutWrite” Strategies)	<ul style="list-style-type: none"> · Writing fully collateralized put options on major equity indices takes advantage of the tendency of option buyers to overpay for downside protection · These strategies earn (currently high) cash returns on derivative collateral

SEEKING DIVERSIFYING RISKS

Alternatives: Diversifying Asset Classes and Strategies	<ul style="list-style-type: none"> · Hedge fund-style strategies with low, neutral or highly flexible equity and bond market exposure, or strategies taking risk outside of traditional financial markets, provide access to manager skill or diversifying risks
Alternatives: Commodities	<ul style="list-style-type: none"> · Commodities in general respond to idiosyncratic supply-and-demand dynamics, and while prices for energy and industrial metals can correlate with broader economic activity, other commodities exhibit very different sensitivities · In particular, commodities tend to perform well during unexpected spikes in inflation (regardless of the broader growth backdrop), when equities and bonds tend to underperform
Alternatives: Private Credit	<ul style="list-style-type: none"> · Direct lending to private equity-sponsored companies is not marked to market, which means it is less volatile on an investor's balance sheet than public assets · Private lending to smaller (but often high quality) companies provides exposure that is increasingly unavailable via public high yield bond or broadly syndicated leveraged loan markets
Alternatives: Private Equity	<ul style="list-style-type: none"> · Private equity is not marked to market, which means it is less volatile on an investor's balance sheet than public assets · Private equity provides exposure to thousands of often high quality, highly innovative companies that are not included in even the small- or micro-cap sectors of stock exchanges

Time to make your money move

The cash yield has become increasingly attractive over the past two years. Today, however, rates appear to have peaked. We think bonds look more attractive than cash, and while current valuations and economic uncertainty might dissuade some investors from quickly moving back to their long-term equity allocations, that raises the risk of repeating the experience of 2023.

That is why we think it is time to consider some first steps in the transition back to risk-taking, and to identify the market levels that would trigger action. Just as important, those trigger levels should include price points that are higher than today's as well as lower, to minimize the risk of holding cash should the equity market recovery consolidate or continue.

Index Definitions

The **ICE BofA 1-3 Year U.S. Corporate Index** measures the market capitalization-weighted performance of public debt of investment-grade corporate issuers, with maturities of between one and three years, issued and denominated in U.S. dollars.

The **ICE BofA U.S. Municipal Securities Index** tracks the performance of U.S. dollar-denominated investment grade tax exempt debt publicly issued by U.S. states and territories, and their political subdivisions, in the U.S. domestic market. Qualifying securities must have at least one year remaining term to final maturity, at least 18 months to final maturity at the time of issuance, a fixed coupon schedule and an investment grade rating (based on an average of Moody's, S&P and Fitch).

The **S&P 500 Index** consists of 500 U.S. stocks chosen for market size, liquidity and industry group representation. It is a market value-weighted index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.

The **Bloomberg U.S. Intermediate Government Bond Index** measures the fixed-rate government-related U.S. bond markets with a maturity greater than one year and less than 10 years.

Disclosures

This material is provided for informational purposes only and nothing herein constitutes investment, legal, accounting or tax advice. This material is general in nature and is not directed to any category of investors and should not be regarded as individualized, a recommendation, investment advice or a suggestion to engage in or refrain from any investment-related course of action. Investment decisions and the appropriateness of this material should be made based on an investor's individual objectives and circumstances and in consultation with his or her advisors. Information is obtained from sources deemed reliable, but there is no representation or warranty as to its accuracy, completeness or reliability. All information is current as of the date of this material and is subject to change without notice. Any views or opinions expressed may not reflect those of the firm as a whole. Neuberger Berman products and services may not be available in all jurisdictions or to all client types.

No recommendation or advice is being given as to whether any investment or strategy is suitable for a particular investor. Information is obtained from sources deemed reliable, but there is no representation or warranty as to its accuracy, completeness or reliability. All information is current as of the date of this material and is subject to change without notice. Any views or opinions expressed may not reflect those of the firm as a whole. Third-party economic, market or security estimates or forecasts discussed herein may or may not be realized and no opinion or representation is being given regarding such estimates or forecasts. Certain products and services may not be available in all jurisdictions or to all client types.

Statements contained herein are based on current expectations, estimates, projections, opinions and/or beliefs of NBIA. This presentation contains "forward-looking" or statements which often can be identified by the use of forward-looking terminology such as "may," "will," "seek," "should," "expect," "anticipate," "project," "estimate," "intend," "continue," "target," "plan" or "believe" or the negatives thereof or other variations thereon or comparable terminology. Such information may include, among other things, projections, forecasts or estimates of cash flows, yields or return, scenario analyses and proposed or expected portfolio composition. Such forward-looking information is based upon certain assumptions about future events or conditions and is intended only to illustrate hypothetical results under those assumptions (not all of which are specified herein). Such statements involve known and unknown risks, uncertainties and other factors, and undue reliance should not be placed thereon. Such statements are necessarily speculative in nature, as they are based on certain assumptions. It can be expected that some or all of the assumptions underlying such statements will not reflect actual conditions. Accordingly, there can be no assurance that any estimated projections, forecast or estimates will be realized or that the forward-looking statements will materialize. Due to various risks and uncertainties, including those set forth herein, actual events or results or the actual performance of any security referenced herein may differ materially from those reflected or contemplated in such forward-looking statements.

Investing entails risks, including possible loss of principal. Investments in hedge funds and private equity are speculative and involve a higher degree of risk than more traditional investments. Investments in hedge funds and private equity are intended for sophisticated investors only. Indexes are unmanaged and are not available for direct investment. **Past performance is no guarantee of future results.**

This material is being issued on a limited basis through various global subsidiaries and affiliates of Neuberger Berman Group LLC. Please visit www.nb.com/disclosure-global-communications for the specific entities and jurisdictional limitations and restrictions.

The "Neuberger Berman" name and logo are registered service marks of Neuberger Berman Group LLC.

NEUBERGER	BERMAN
-----------	--------

Neuberger Berman

1290 Avenue of the Americas
New York, NY 10104-0001

www.nb.com