

Pause for Longer as Inflation Progress Stalls

Note: This is an update to “Investors in Cash Vehicles at Risk of Not Locking in Rates”, “When the Rate Levee Breaks”, and “Investing When Yield Curve Is Inverted” originally published by Freedom Advisors in September 2024, February 2024, and June 2023, respectively.

The end of 2024 saw long-term bond yields rise following the Federal Reserve's decision to cut its benchmark rate by 0.50% at the September 2024 FOMC, as a preemptive measure to ease policy in the face of a summertime slowdown in labor markets. However, the U.S. economy picked up steam in the 4th quarter with inflation-adjusted GDP growing at 2.3% (QoQ %SAAR), while disinflationary trends stalled with core US Personal Consumption Expenditure (PCE) rising 2.8% at year-end, well above the Fed's forecast. Even as the Fed cut its benchmark rate by a total of 1% by year-end from 5.50% to 4.50%, long rates rose in anticipation of a pause in further rate cuts as the 10-year U.S. Treasury yield rose to 4.56% from a low of 3.62% prior to the September FOMC rate cut.

The January 2025 FOMC confirmed the rate cut pause as the FOMC statement and Chair Powell press conference remarks signaled a more cautionary view on further disinflation progress, while remarking on the robust health of labor market conditions and warning about the consequences of loose fiscal policy and trade policy uncertainty. As short-term rates remain elevated around 4.25-4.50%, investors continue to park assets into money market funds and other cash instruments, with money market fund assets reaching \$6.9 trillion towards the end of January 2025, up from \$4.5 trillion prior to the 2022-2023 Federal Reserve rate hike cycle.

The popularity of money market funds can be attributed to investors seeking a safe harbor from the volatility experienced over the post-COVID period when interest rates rose sharply in reaction to high inflation. As interest rates gyrated throughout 2024, investment grade bonds only returned 1.25%, less than the offering yield at the beginning of 2024. Despite a strong recovery in 2023, U.S. fixed income risk remains out of favor until investors receive clarity on the inflation front.

The Fed also updated their Summary of Economic Projections at the December meeting, including the dot plot consensus of the expected rate path for the following two years. The market implied magnitude and pace of expected rate cuts slightly differs from that of the Fed's projections, as both the Fed and the rates market have pulled back expectations of rate cuts throughout 2025, while the Fed expects to ease policy at greater pace throughout 2026 than what is priced in by the rates market.

One may be surprised to find on the pages that follow that locking in a lower rate for a few months compared to remaining in money market funds, despite comparable yields, can pay off over the long run, especially if we see a drop in short-term rates over the next couple years as implied by market pricing.

Looking at the yield curve and available fixed income strategies, the most important factor to weigh is your client's investment objective and time horizon or aligning client spending time horizons with portfolio maturity schedules. Short-term spending needs are usually funded with short-term maturity instruments. If your clients don't have short-term spending needs, you have an opportunity to lock in high inflation-adjusted rates over a longer period.

			Growth of \$100,000		
Term	3 Month Implied Forward Rates (SOFR)	5-Year Treasury Bond Yield	Term	Money Market Proxy	5-Year Treasury Bond
1M	4.32	4.30	1M	\$100,353	\$100,352
2M	4.28	4.30	2M	\$100,707	\$100,704
3M	4.24	4.30	3M	\$101,059	\$101,059
4M	4.15	4.30	4M	\$101,409	\$101,414
5M	4.15	4.30	5M	\$101,754	\$101,771
6M	4.07	4.30	6M	\$102,099	\$102,128
7M	4.01	4.30	7M	\$102,439	\$102,487
8M	4.01	4.30	8M	\$102,775	\$102,848
9M	3.95	4.30	9M	\$103,113	\$103,209
10M	3.92	4.30	10M	\$103,446	\$103,572
11M	3.92	4.30	11M	\$103,778	\$103,937
12M	3.89	4.30	12M	\$104,111	\$104,302
2-Years	3.89	4.30	2-Years	\$108,158	\$108,789
3-Years	3.93	4.30	3-Years	\$112,403	\$113,469
4-Years	4	4.30	4-Years	\$116,896	\$118,351
5-Years	4.08	4.30	5-Years	\$121,663	\$123,442

The 3-month Secured Overnight Financing Rate (SOFR) serves as a valuable surrogate for gauging both current and anticipated money market fund rates. By examining the implications of diminishing yields, particularly when manifesting an inverted curve, as reflected in the SOFR curve, this table illuminates the consequential disparities in income generation. A comparative analysis is drawn between the income derived from the money market fund proxy and that emanating from a fixed 5- year maturity Treasury Bond or a 5-year A-Rated Corporate Bond*.

Initially, the income from the money market fund surpasses that of the 5-year bond, offering a higher return at the outset.

However, the yield advantage quickly tapers off, as the income from the money market fund proxy falls behind that of the 5-year bond. This disparity starts with the anticipation of lower interest rates, underscoring the need to look ahead as well as at current markets.

			Growth of \$100,000		
Term	3 Month Implied Forward Rates (SOFR)	5-Year A-Rated Corporate Bond	Term	Money Market Proxy	5-Year A-Rated Corporate Bond
1M	4.32	4.86	1M	\$100,353	\$100,396
2M	4.28	4.86	2M	\$100,707	\$100,793
3M	4.24	4.86	3M	\$101,059	\$101,192
4M	4.15	4.86	4M	\$101,409	\$101,593
5M	4.15	4.86	5M	\$101,754	\$101,995
6M	4.07	4.86	6M	\$102,099	\$102,399
7M	4.01	4.86	7M	\$102,439	\$102,804
8M	4.01	4.86	8M	\$102,775	\$103,211
9M	3.95	4.86	9M	\$103,113	\$103,620
10M	3.92	4.86	10M	\$103,446	\$104,030
11M	3.92	4.86	11M	\$103,778	\$104,442
12M	3.89	4.86	12M	\$104,111	\$104,855
2-Years	3.89	4.86	2-Years	\$108,158	\$109,946
3-Years	3.93	4.86	3-Years	\$112,403	\$115,284
4-Years	4	4.86	4-Years	\$116,896	\$120,881
5-Years	4.08	4.86	5-Years	\$121,663	\$126,749

*Source: Bloomberg. Data as of 1/30/2025. For illustrative purposes only. This analysis assumes 3-month annualized rates are realized as projected by SOFR interpolated pricing as of 1/30/2025 and a flat yield curve for the reinvestment of the 5-year Treasury Bond and A-Rated Corporate Bond (no default) held to maturity.

Conclusions

- Short-term fixed-income has greater reinvestment risk.
- Longer-term fixed-income allows investors to lock in rates.
- Aligning investor time horizons with portfolio maturities helps address both reinvestment risk and total return risk resulting from interest rate volatility.

Guidance

[Read our recent guidance](#) regarding how to restructure fixed-income portfolio duration.

Freedom Advisors has a diversified lineup of fixed-income strategies including strategies that take on the management of duration and diversification, as well as specific duration and sector strategies. The portfolio models below are a few suggestions available today in Freedom Advisors:

Managed Duration:

- [EQIS 5yr Corp Bond Ladder ETF Strategy](#)
- [EQIS 7yr Muni Ladder](#)

Managed Income:

- [PIMCO Income Fund](#)
- [SignalPoint Stable Income](#)

Flexible Fixed-income:

- [Financial Trust Flexible Income](#)
- [SignalPoint Stable Income](#)

ESG Fixed-income:

- [Calvert ESG Bond Fund](#)
- [EQIS ESG High Yield Debt ETF](#)

Short Duration:

- [EQIS Short Term credit ETF](#)
- [Calvert ESG Short Duration Income Fund](#)

If you would like to discuss the fixed income markets or the model offerings above, please reach out to your Freedom Advisors Consulting Team.



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