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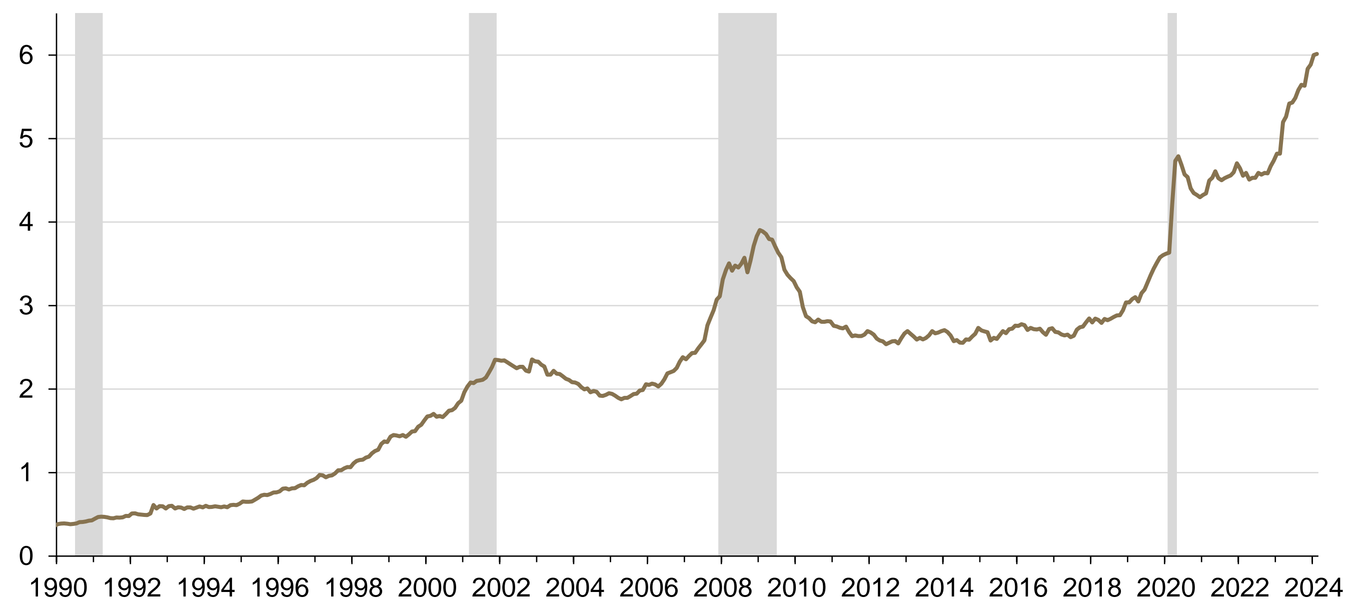
GUARDIAN CAPITAL US MARKET Q1 2024 COMMENTARY

FEBRUARY 2024

Cashing out

Money market funds have experienced a surge of inflows in recent years. These short-term investment vehicles have been the only fund asset class in the US to see positive net sales over the last two years, with their net assets under management jumping by more than US$1 trillion (+25%) over that period to a record-high of nearly US$6 trillion. Net assets have now more than doubled since the end of 2019, a magnitude of increase only ever seen before during the height of the financial crisis in 2008.

Total money market fund net assets, US
(trillions of US dollars)



Shaded regions represent periods of US recession. Source: Guardian Capital based on data from the Investment Company Institute and Bloomberg to February 14, 2024

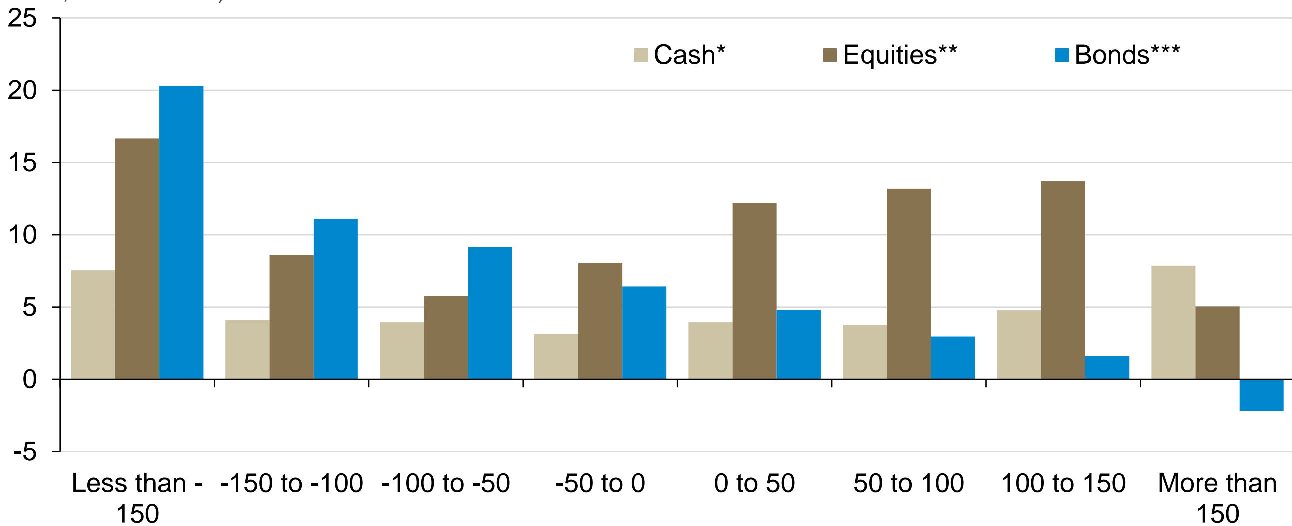
As was the case a decade and a half ago, heightened uncertainty and volatility in the marketplace increased the appeal of a relatively conservative, highly liquid place to stash cash. A bigger driver of this flood of money to the money market this go-round, however, has been the sharp increase in market interest rates that makes cash compelling from an investment performance perspective for the first time in many current investors' adult lives.

Indeed, the 5.0% total return on cash (as proxied by the ICE BofA US Treasury Bill 3-month Index[1]) last year represented the asset class's best calendar performance in 23 years — and while the outsized rally across financial markets in the final two months of 2023 resulted in it lagging the returns on equities (S&P 500 Index[2] +26% total return) and bonds (ICE BofA US Broad Market Index[3] +5.4%), its cumulative 6.5% return over the last two years handily outpaced

the other asset classes (S&P 500 Index +3.4% total return over the same period; -8.5% for the ICE BofA US Broad Market Index) while enduring little of their volatility.

Interestingly, this cash outperformance, as market interest rates surged (the 10-year US Treasury Note yield increased by 2.37% over the two years ended December 31, 2023) is not a historical anomaly. In fact, it is the norm in these market conditions, as data covering more than four decades show that cash is the top-performing asset class on average when rates rise by at least 1.50% (a top 10 percentile move).

Asset class average 12-month total return by change in rates
(percent; US dollar basis)



12-Month Change in 10-Year Treasury Yield in basis points

**Cash=ICE BofA US 3-month T-Bill Index; **Stocks=S&P 500; ***Bond=ICE BofA US Broad Market Index. Source: Guardian Capital based on data from Bloomberg from January 1979 to January 2024.*

It is, however, only in these extreme scenarios where cash has historically been the best option for investors.

In periods of more modest increases in market interest rates — which typically coincide with an upswing in the market cycle in which growth and inflation are rising and increasing the anticipation of central bank rate increases — equities are the top performers on average. The same holds true when rates stay roughly flat. Periods of declining interest rates — which typically coincide with more down economic outlooks that presage central banks easing policy — see bonds outperform.

Looking to the months ahead, central banks are broadly expected to begin cutting rates as progress on getting inflation back within the realm of “normal” allows policymakers to return to a more “neutral” setting as they try to navigate a “soft landing.” While the timing and magnitude of cuts are going to be a matter for debate, there is an overwhelming consensus on the direction (barring some sort of inflationary shock that spurs central banks into further action).

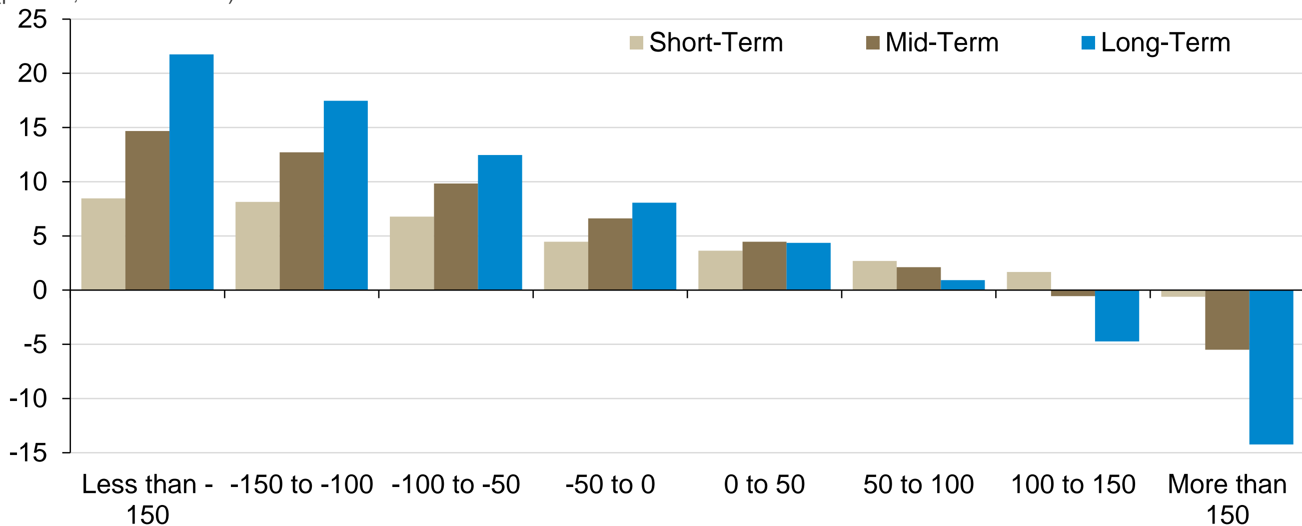
The prospect of lower interest rates could mean lower returns and increased reinvestment risk, which makes the ‘case for cash’ less compelling relative to other asset classes that have historically fared better in more benign interest rate environments — and any redeployment of that huge cache of cash (equivalent to 12% of the total US equity market capitalization) could potentially provide a lift to other asset classes.

As such, while the outlook remains uncertain, it would appear investors who find themselves sitting on an abundance of cash may look to benefit their longer-term financial health by adding duration to portfolios.

Fixed-income securities that have longer terms allow investors to lock in current market yields for a longer period and may also stand to incur a capital gain, as bond prices move inversely with interest rates (i.e., bond prices rise as rates fall) — the longer the maturity, the more sensitivity to rates.

Fixed Income average 12-month total return by change in rates*

(percent; US dollar basis)



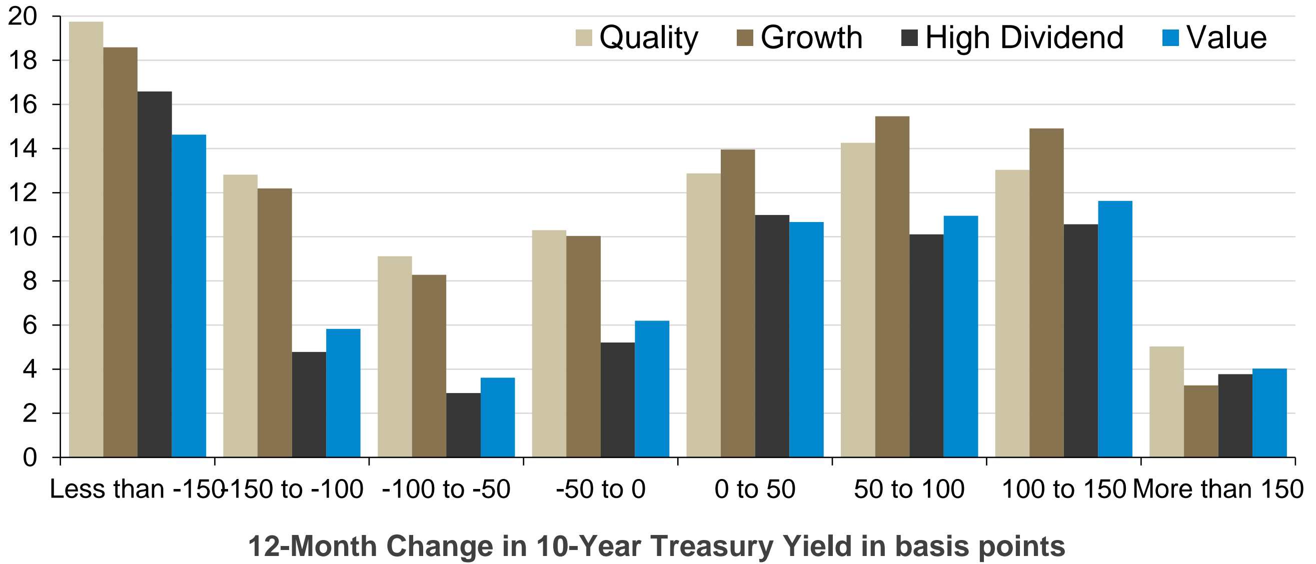
12-Month Change in 10-Year Treasury Yield in basis points

**ICE BofA US bond indexes[4]. Source: Guardian Capital based on data from Bloomberg from January 1979 to January 2024.*

Similarly, equities that derive more of their value from their underlying company’s future growth prospects than current cash payments tend to outperform as interest rates fall — a lower discount rate means that future cash flows factor more heavily in valuations, giving a lift to prices all else the same.

Equity style average 12-month total return by change in rates*

(percent; US dollar basis)



**MSCI US style indexes[5]. Source: Guardian Capital based on data from Bloomberg from January 1979 to January 2024.*

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All figures in USD, unless otherwise stated. For definitions of the indices mentioned in this document, please contact Guardian Capital LP at insights@guardiancapital.com

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[1] The ICE BofA US 3-Month Treasury Bill Index is comprised of a single issue purchased at the beginning of the month and held for a full month. At the end of the month, that issue is sold and rolled into a newly selected issue.

[2] The S&P 500 is an index of 500 stocks designed to reflect the risk/return characteristics of the large-cap US equity universe.

[3] The ICE BofA US Broad Market Index tracks the performance of investment-grade debt publicly issued in the US markets, including sovereign, quasi-government, corporate, securitized, and collateralized securities.

[4] ICE BofA US bond indexes:

- "Cash" = ICE BofA US 3-month Treasury Bill Index (see endnote 1 above).
- "Short-Term" = The ICE BofA 1- to 5-Year US Corporate & Government Index = The ICE BofA US Corporate & Government Index tracks the performance of investment-grade debt publicly issued in the US markets, including sovereign, quasi-government, and corporate securities with maturities between 1 and 5 years.
- "Mid-Term" = The ICE BofA 5- to 10-Year US Corporate & Government Index = The ICE BofA US Corporate & Government Index tracks the performance of investment-grade debt publicly issued in the US markets, including sovereign, quasi-government, and corporate securities with maturities between 5 and 10 years.
- "Long-Term" = The ICE BofA 10+ Year US Corporate & Government Index = The ICE BofA US Corporate & Government Index tracks the performance of investment-grade debt publicly issued in the US markets, including sovereign, quasi-government and corporate securities with maturities greater than 10 years.

[5] The MSCI US Equity indexes are a domestic-only series – independent from MSCI's Global Equity indexes – which reflect the investment opportunities in the US equity markets by market capitalization size, value, and growth investment styles, and by sectors and industries.

- "Quality" = The MSCI US Quality Index includes large and mid-cap stocks in the US equity market. The index aims to capture the performance of quality growth stocks by identifying stocks with high-quality scores based on three main fundamental variables: high return on equity (ROE)[a], stable year-over-year earnings growth [b], and low financial leverage[c].
- "Growth" = The MSCI USA Growth Index captures large and mid-cap securities exhibiting overall growth style characteristics in the US. The growth investment style characteristics for index construction are defined using five variables: long-term forward EPS growth rate[d], short-term forward EPS growth rate[d], current internal growth rate[f], long-term historical EPS growth trend[g], and long-term historical sales per share growth trend [h].
- " Value" = The MSCI USA Value Index captures large and mid-cap US securities exhibiting overall value style characteristics. The value investment style characteristics for index construction are defined using three variables: book value to price[i], 12-month forward earnings to price[j], and dividend yield[k].
- "High Dividend" = The MSCI USA High Dividend Yield Index includes large and mid-cap stocks. The index is designed to reflect the performance of equities in the parent index (excluding REITs[l]) with higher dividend income and quality characteristics than average dividend yields that are both sustainable and persistent.

[a] Return on equity (ROE) is the measure of a company's net income divided by its shareholders' equity.

[b] A price/earnings-to-growth (PEG) ratio is a stock's price-to-earnings (P/E) ratio divided by the growth rate of its earnings for a specified period.

[c] Leverage is using debt (borrowed funds) to amplify returns from an investment or project.

[d] Earnings per share (EPS): How much profit a company has made per share within a given period. EPS is an arbitrary number by itself because the company can control the number of shares outstanding through splits and buybacks. But comparing a company's most recent EPS to its EPS in previous years and quarters (adjusted for any splits) is one of the most common ways of telling how fast the company's profits are growing.

[f] Current internal growth rate (IGR) is the highest level of growth achievable for a business without obtaining outside financing.

[g] Long-term historical EPS growth trend is a measure of how the EPS has grown over the last five years.

[h] Sales per share is a measure of a company's total sales divided by shares outstanding.

[i] Book value to price measures the market's valuation of a company relative to its book value.

[j] A 12-month forward P/E ratio divides the current share price of a company by the estimated forward EPS of that company.

[k] Dividend yield is a financial ratio that shows how much a company pays out in dividends each year relative to its stock price.

[l] Real Estate Investment Trust (REIT) is a company that owns, operates, or finances income-generating real estate.