EAGLE | Asset Management

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10-year Treasury yields vs. money market returns

How long would a money market fund need to maintain current rates to match the return of a 10-year Treasury note?

	Year										Total yield		
Yield scenarios	1	2	3	4	5	6	7	8	9	10	Cumulative	$ Return, $1M invested	Annualized
10-year U.S. Treasury yield	4.83%	4.83%	4.83%	4.83%	4.83%	4.83%	4.83%	4.83%	4.83%	4.83%	60.27%	$1,602,660	4.83%
Short-term breakeven yield	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%	4.86%	2.50%	2.50%	60.27%	$1,602,660	4.83%
FOMC fed funds rate projections	5.63%	5.50%	4.63%	3.50%	2.75%	2.50%	2.50%	2.50%	2.50%	2.50%	40.28%	$1,402,801	3.44%

Scenario 1: Yield profile of a 10-year U.S. Treasury note with a yield-to-maturity of 4.83%.

Scenario 2: Yield profile based on the number of years the federal funds rate would have to stay around the current level of 5.50% before returning to the FOMC's projected long-term rate of 2.5% so that the yield profile of short-term fixed income assets over a 10-year period will equal the yield profile a 10-year U.S. Treasury note with a yield-to-maturity of 4.83% (Scenario 1).

Scenario 3: Yield profile based on the median of federal funds rate estimates as part of the FOMC's summary of economic projections.

Source: Bloomberg, U.S. Federal Reserve, and Eagle estimates; data as of Oct. 17, 2023.

This is a hypothetical example for illustration purposes only and does not represent an actual investment. There is no guarantee that the investment goals/objectives will be met.

Our view

In a falling interest rate environment, which typically follows the end of a U.S. Federal Reserve hiking cycle, owning bonds with longer duration rather than money market instruments could provide a tailwind to long-term investors. Bonds with duration, such as Treasury bonds or corporate bonds, typically offer yields and fixed interest payments over an extended period, allowing for stability in income throughout that period. When interest rates decline, the value of existing bonds tends to rise, providing capital appreciation potential for bondholders in addition to higher interest rates earned over the life of the bond.

The problem with higher-yielding money markets

This contrasts with money market instruments, like Treasury bills (T-bills) or short-term certificates of deposit, which offer stated yields for short periods. This allows for reinvestment risk when rates change. Their rates of interest paid reset frequently, meaning that lower rates could be received after the reset than if longer bonds were held.

By investing in longer-term bonds, one can potentially benefit from both regular interest income and the opportunity for increased bond values, effectively capitalizing on the inverse relationship between bond prices and interest rates in a falling rate environment.

The Eagle team has noted that many investors have flowed into money market funds based on high promised interest rates, but the short-term nature of these rates is not understood. While these rates are attractive for the short term, they ultimately may not serve the long-term investor.

The advantage of longer-dated bonds

The scenarios outlined above detail an estimate of the yield profile for the 10-year Treasury note compared to current money market rates and rate expectations laid out by the Federal Reserve. It shows that for an investment of $1 million at current short-term rates, money market funds would need to maintain their current rates for more than seven years before falling to Federal Open Market Committee (FOMC) projections to match the return of the 10-year Treasury over the same period. This is not likely and is something long-term investors need to understand.

Ultimately, while money markets can be used to supplement short-term cash needs, they are not investments. In today's environment, longer-duration bonds look very attractive at yields currently available and could make it worthwhile to sacrifice shorter-term yields for higher longer term ending values.

Risks associated with Fixed Income investing:

Many investors consider bonds to be “risk free” investment vehicles. Historically, bonds have indeed provided less volatility and less risk of loss of capital than has equity investing. However, there are many factors that may affect the risk and return profile of a fixed-income portfolio. The two most prominent factors are interest-rate movements and the creditworthiness of the bond issuer. Bonds issued by the U.S. government have significantly less risk of default than those issued by corporations and municipalities. However, the overall return on government bonds tends to be less than these other types of fixed-income securities. Investors should pay careful attention to the types of fixed-income securities that comprise their portfolio and remember that, as with all investments, there is the risk of the loss of capital.

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Definitions

Duration incorporates a bond’s yield, coupon, final maturity, and call features into one number, expressed in years, that indicates how price-sensitive a bond or portfolio is to changes in interest rates. Bonds with higher durations carry more risk and have higher price volatility than bonds with lower durations.

The federal funds rate, known as the fed funds rate, is the target interest rate set by the Federal Open Market Committee of the U.S. Federal Reserve. The target is the Fed’s suggested rate for commercial banks to borrow and lend their excess reserves to each other overnight.

The Federal Open Market Committee (FOMC) consists of 12 members: the seven members of the Board of Governors of the Federal Reserve System; the president of the Federal Reserve Bank of New York; and four of the remaining 11 Reserve Bank presidents, who serve one-year terms on a rotating basis. The FOMC holds eight regularly scheduled meetings per year at which it reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth.

The maturity date is when a debt comes due and all principal and/or interest must be repaid to creditors. Short-maturity debt is debt that must be paid on a near-time time horizon, often in less than a year or even in a matter of months. Long-maturity debt is debt with a maturity of more than 12 months.

The summary of economic projections (SEP) is produced following meetings of the Federal Open Market Committee and includes meeting participants’ projections of the most likely outcomes for real gross domestic product growth, the unemployment rate, and inflation for a forward-looking three-year window and over the longer run.

About Eagle Asset Management

Eagle Asset Management provides a broad array of fundamental equity and fixed-income strategies designed to meet the long-term goals of institutional and individual investors. Eagle’s multiple independent investment teams have the autonomy to pursue investment decisions guided by their individual philosophies and strategies.