# Make Your Money Move

**Disruptive Forces in Investing** **April 9, 2024**

**Anu Rajakumar:** For the first time since the onset of the COVID-19 pandemic, the Federal Reserve and other key Central Banks are poised to cut interest rates in 2024. One topic that's been on the minds of many is the anticipated decline of highly attractive cash rates. My name is Anu Rajakumar, and on today's episode we'll be drawing on insights from Neuberger Berman's latest paper titled *Cash Balances: Is It Time to Make Your Money Move?* which is part of our broader Make Your Money Move campaign. I'm very excited to welcome one of the authors of that paper, Rebekah McMillan, associate portfolio manager on the multi-asset team to discuss how investors can prepare to put their cash to work and navigate the investment opportunities ahead. Rebekah, welcome to the show.

**Rebekah McMillan:** Thanks, Anu. Great to be here.

**Anu:** Now, Rebekah, cash rates have been so attractive in recent months, so can you give us a recap about where we've come from and why cash rates have been so high relative to historical levels?

**Rebekah:** You're absolutely right. So for a long time, nominal returns on cash were virtually zero, but this has completely switched following the rate hikes delivered by central banks globally over 2022 and 2023 in response to surging inflation levels. So cash rates have risen significantly, reaching over 5% in the US anyway, and that's made cash a more viable temporary store of value, particularly for risk-averse investors who are more wary given the backdrop of economic uncertainty. And we know that investors have been using that flexibility as it's in money market funds are at all-time highs, $6 trillion in the US and $9 trillion worldwide.

**Anu:** Yeah, no, and actually I've seen those charts of those money market assets and it really jumps up dramatically in the recent periods. So as you said, you know, $9 trillion on the sidelines worldwide, but of course, the macro picture is evolving. So tell us what's changed.

**Rebekah:** Well, primarily, the economic picture has improved. So global growth, though slowing, has demonstrated resilience, particularly in the US where that near-term risk of recession has receded. We're also seeing a turn in global manufacturing activity and a positive growth story in Japan. And even in Europe, you know, the outlook is improving as German and UK economies emerge from this more stagnant period. So the expectation is for continued global growth this year, albeit slowing. And alongside that, we've seen inflation come down dramatically from the double-digit peaks of 2022.

Yes, there is some stickiness in the so-called last mile, you know, particularly in services inflation, there's pressure from rising wages and shelter costs that we all know about. But in general, inflation being at much more controlled levels and moving towards central bank targets clears the path for that monetary policy loosening. So the prospect of these central bank rate cuts, whilst the tailwind to many other asset classes, is actually a challenge for cash. And we know that cash has this inherent reinvestment risk. As we expect to see rates come down, it becomes less attractive on a relative basis. And if you look historically, cash has actually very rarely kept pace with inflation over the long term. So we think now is a good time for investors to start thinking about their long-term investment opportunities.

**Anu:** Okay, Rebekah, you mentioned the tailwind to other asset classes, so let's dig into that a little bit. As allocators consider that transition out of cash and repositioning their portfolios, where are the opportunities?

**Rebekah:** It's probably helpful to think about some of the reasons that investors may be holding cash and where in the market we see attractive investments with those properties. So firstly, durable income. You know, in public fixed-income markets, investors can lock in attractive yields even at the shorter end of the curve, which hasn't been the case for many years.

So we're looking at kind of four to seven-year government and high-quality credit and that importantly you're locking in that level of yield over a period of time with the potential for price appreciation from yields moving lower also. But there are other interesting areas to harness income. You know, asset-backed lending, for example, or infrastructure. They're very different

investments, but they can provide contractual cash flows and give investors exposure to areas in private markets in real need of capital and be rewarded for doing so.

Secondly, diversification. Particularly when stock-bond correlations can be positive, as we've seen both on the downside and the upside in 2022 and 2023. We think allocations to non-traditional or alternative asset classes such as commodities, hedge funds-style strategies such as global macro or equity long short we believe can play an important role in an investor's portfolio. And those less correlated return streams and exposure to alternative risk premier can protect portfolios from future shocks, for example, in inflation.

But again, in the private market space, although not uncorrelated, broadening portfolios to access a more diverse sets of risk premier with less market-to-market volatility can support portfolio efficiency. So through private equity, you're accessing exposure to thousands of often high-quality innovative companies of much smaller size than the public markets. And then within private credit, the current market dynamics and changing bank financing landscape have pushed terms in favor of lenders. So you get the higher base rate, the spread, and the potential for greater creditor protection through deal structuring.

**Anu:** Yep, that's great. Thank you. I want to just pick up on a couple of things that you mentioned in that response. You know, first, when you spoke about durable income you specifically said government and high-quality credit fixed income is an area that we find particularly attractive. So I just want to make a distinction, you didn't say all areas of fixed income. Can you just talk about that nuanced view a little bit?

**Rebekah:** Yeah, so it's more of a relative value assessment. So, for example, we didn't mention high yield but our outlook for credit stress remains fairly mild and definitely idiosyncratic rather than systemic. Leverage levels are low, for example. Interest coverage is high in general and that maturity rule of high-yield debt that was quite concerning has been pushed out quite substantially. If you look at the US high-yield market, almost 50% of those 2024 and 2025 maturities coming up have been pushed out in the last year.

So we do see a case for shorter duration, high-quality exposure within the high yield universe for investors who are seeking more potential return. That said, spreads are at pretty tight levels and in many cases, tighter than the fundamentals may warrant, which makes us fairly neutral on the asset class as a whole.

**Anu:** Rebekah, one other thing I wanted to just ask about was stock-bond correlations, which as you mentioned were positive in two very different years, 2022 and 2023. So my question for you is, what is the outlook, um, for that stock-bond correlation? Do you think it’s going to continue to be positive going forward?

**Rebekah:** Yeah, it's a very important question and it's actually something that we did quite a lot of research into looking back over history, how these correlations evolve over time and how that's linked to inflation, but in particular inflation volatility. So if you look back since 1970, there have been extended periods of time where stock and bond correlationships were positive. It's just that we've become quite accustomed since the 2000s with this being negative and providing many, you know, 60/40 investors or stock and bond investors with this natural hedge to their portfolios and them providing that diversification benefit.

Now in periods of elevated inflation volatility, we see that stock-bond correlation be positive and we would expect to see that continue going forward. And that obviously has important implications for portfolio construction. And we definitely believe that investors should be looking outside of traditional stocks and bonds for uncorrelated and alternative assets that can be a source of diversification in portfolios.

**Anu:** Great, thanks very much Rebekah. Now let's turn to the equity markets, for years post the global financial crisis, the Fed kept rates low at near 0% and in many of those years, the stock market posted years of strong returns. So now with the expectations of rates turning lower, one might expect a similar conviction in equities. But as you mentioned before, we are already in an environment of slowing growth and elevated valuations. So, with that in mind, how should investors proceed when it comes to equities?

**Rebekah:** Well, we definitely understand investor caution. You know, there's still economic uncertainty and risks around, and there's also been a strong rebound in the equity market since the lows of October 2022. Certain valuations in certain areas of the market are looking rich. But if you analyze the data, valuations alone offer very little predictive power on near-term returns. So historically, an S&P 500 price to earnings multiple of between 18 and 20 times has been followed by an average one-year excess return of four plus percent.

So we try not to base our investment decisions on valuations alone, and we've actually become constructive on equities. Given the improvements in the economic backdrop, you know, high nominal growth should be supportive, as should the central bank easing cycle. But we do recognize the risks associated with very narrow and momentum-driven markets and prefer adding thoughtfully to equity market exposures rather than, say, aggressively adding equity market beta. So exposure to quality companies, you know, with strong market positions, strong balance sheets, high free cash flow.

You know, the topic of this podcast, right? Cash offers huge flexibility for corporates. And whilst it's been earning interest, it's really significantly advanced the position of some companies we've seen. But we're also seeing interesting opportunities in unloved areas of the market and those laggards where performance has disappointed. For example, US small cap, there's a potential for a comeback there.

Regionally, we have been and remain overweight to Japan, and that's more for structural reasons as well as the prospect of sustained growth and inflation. We expect to see a continuation of the corporate reform agenda that can unlock value for Japanese equity owners. But of course, where markets are at risk of getting overextended, we emphasize the importance of sticking to an investment discipline and beware animal spirits.

**Anu:** I like that. Beware animal spirits or as I think of it, the emotional rollercoaster that we as investors experience, especially during some of those really difficult and tough markets, right?

**Rebekah:** Absolutely. And we are observing a lot of all-time highs, you know, whether that be the S&P, the NIKKEI, the Dax, or in other parts of the market such as gold or Bitcoin. And there may be justifiable reasons, but these are very different asset classes and signals to us that there's still an abundance of liquidity in the system plus the cash that's waiting on the sidelines that we discussed earlier. So for us it's about avoiding speculation, but instead investing in assets which have value we believe will appreciate over the long term.

**Anu:** Absolutely makes sense. Well, Rebekah, as we wrap up here, give our listeners some actionable steps or other key takeaways that they can think about moving forward from here.

**Rebekah:** Well, really there's no time like the present to put cash to work and the opportunity cost of doing nothing is an underappreciated risk. Secondly, I'd just say, try to look beyond short-term volatility, find the best risk-adjusted opportunities and stay the course.

**Anu:** Great. Well that is a great place to end, Rebekah, but I can't let you go without a quick bonus question.

As I mentioned in the introduction, Neuberger Berman's current campaign theme is Make Your Money Move. So my question for you is, considering that much of your time is spent at a desk job, how do you like to move? Whether it's dance, sports, biking or something else perhaps?

**Rebekah:** It's a great question, and my movement is actually quite niche, but I do Brazilian jitsu which is a martial art. And without being too pretentious, you know, it's pretty strategic. So you're anticipating your opponent's next moves and you're trying to stay ahead. It's like a physical game of chess. But at the very least it teaches you resilience, you know, to take your wins and your losses and it's a pretty good simulation for life sometimes.

**Anu:** I was going to say, and it actually seems very aligned with a role as an asset allocator. So that's very on-brand. I'm very impressed.

**Rebekah:** Very much so.

**Anu:** Well, thank you very much for sharing that and for your thoughts today. You know, what you've talked about today, I think really represents an important crossroads ahead for investors, particularly those who have, you know, been sitting quite comfortably in cash for a number of months. You talked about durable income, diversification and the value add of private markets. And I think as we draw ever close to that first rate cut, it seems like more and more investors are indeed going to be looking to get off the sideline and putting their cash to work in the markets. So once again, thank you for being here and for sharing your thoughts.

**Rebekah:** Thank you.

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