2021 Corporate Cash Outlook

Leave the Pennies to the Steam Rollers

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Low yields, elevated uncertainty, and challenging conditions – 2021 promises no shortage of risks to navigate. Read on for our latest thinking.

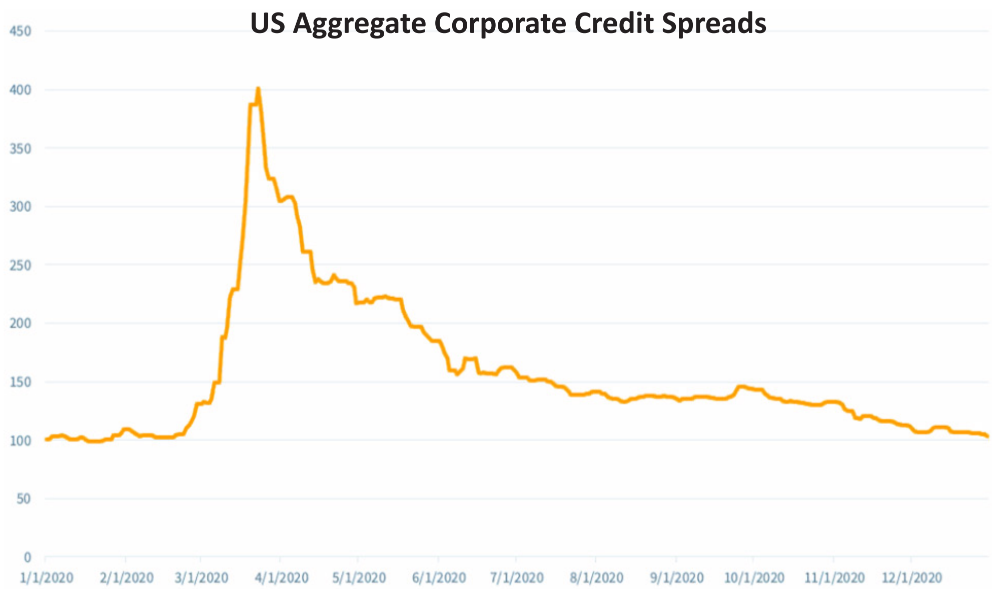
Throw Out the Textbooks

This time last year, the Treasury curve was flat with yields in the mid-one percent range. While the curve remains flat today, that's where the similarities end. Corporate cash investors must once again face the sobering reality of rock-bottom risk-free rates.

Maturity	As of 1/1/20 Treasury Yield	As of 1/12/21 Treasury Yield	Change in Yield
3 Mo	1.55%	0.08%	-1.47%
6 Mo	1.58%	0.08%	-1.50%
1 Year	1.58%	0.10%	-1.48%
2 Year	1.57%	0.14%	-1.43%
3 Year	1.61%	0.23%	-1.38%
5 Year	1.69%	0.49%	-1.20%

Source: Bloomberg

It's a similar situation in credit markets, where the yield on A-rated corporates ranges from 0.20-0.30% for maturities within 2 years to 0.40-0.90% for maturities between 3-5 years. Credit spreads have round tripped back to pre-pandemic levels. *At these yields, given the upcoming vaccine distribution and phased reopenings, investors must pay close attention to portfolio structure and liquidity.*



Source:CreditSights (ICE BofA US Corporate Index)

We're still in the midst of a worsening global pandemic and the most serious recession since WWII, yet fixed income markets are priced to perfection. So what's the playbook for short term investing in 2021?

Watch the Fed

The Fed will maintain its dovish stance until either the fundamental economic recovery is well underway or circumstances (e.g. inflation) force their hand. Our base case assumes successful mass vaccinations which turn the economic tide and allow for a reopening of the US economy by Q4 2021. The return to normalcy ought to be a boon:

1. The all-clear signal unleashes the dual forces of colossal stimulus and pent-up consumer demand. A sustained wave of relief spending reignites economic activity, increasing input prices throughout the supply chain.
2. Subsequent pickups in hiring set the stage for labor market recovery, reducing unemployment, nudging incomes higher, and perpetuating a virtuous feedback loop that further increases consumer demand. Any incremental fiscal stimulus only reinforces the trend.
3. A satisfied Fed, under its newly-adopted policy of “Average Inflation Targeting,” is content to allow any resulting inflationary consequences to “run hot” and “balance out” the prior decade of below-trend inflation.

Markets are currently ignoring the grim near-term surge in Covid cases and are focused on the light at the end of a long tunnel. Under this scenario, rates likely end up creeping marginally higher to reflect the accelerating recovery and rising risk of inflationary consequences. But there are any number of factors that can cause that light to fade – delayed vaccine deployment, new virus mutations that render the existing vaccines obsolete, stubbornly persistent unemployment, etc. Should a “bear” case derail markets’ hopes, we expect rates to stay broadly unchanged, as the Fed fights the next fire by staying pat or easing further.

From the corporate cash investor’s perspective, the risks are nuanced. At current yields and spreads, small upwards shifts in rates can generate unrealized price losses that wipe out the low income returns, while potential upside is capped given how close current yields are to zero. On the other hand, staying short requires accepting essentially zero return while ignoring a Fed that’s practically yelling through a bullhorn that ultra-easy money is here to stay.

Estimated Price Losses for Example Bonds

		Rates Rise 0.25%		Rates Rise 0.50%	
Maturity	Current Yield	New Yield	Price Loss	Niew Yield	Change in Price
3 Mo	0.21%	0.46%	-0.25%	0.71%	-0.51%
6 Mo	0.46%	0.71%	-0.72%	0.96%	-1.43%
1 Year	0.89%	1.14%	-1.23%	1.39%	-2.43%

Source: Treasury Partners estimates as of 1/12/21

Treasury Partners View

The heavy hand of the Fed will continue weighing on yields for years to come. It's a foregone conclusion that the Fed Funds rate won't budge off 0% for the next two years (and potentially, 3 years!). Further, we don't expect they'll begin tapering their massive $120 billion/month of Quantitative Easing in 2021.

We might see the rumored implementation of yield curve control ("YCC") if longer term Treasury rates were to rise faster than the Fed would prefer. This would result in the Fed buying 10-30 year Treasuries to add further downward pressure on shorter-term rates.

The corporate cash investor's dilemma is painfully simple - earn very little by staying short, or earn a slightly more by extending maturities but risk unrealized price declines if rates rise even moderately. We recommend striking a balance; those clients who can extend maturities past 1 year should carefully manage maturities inside of 1 year and retain money market fund equivalents to fund short term liquidity needs. Investors with a 2-year maximum maturity should target 12-24 month bonds.

For investors with longer maximum maturities, we don't advise stretching to the edge of a portfolio's limits, as the incremental yield for extending each additional year is nominal. Instead, investors with 3-5 year maximum final maturity constraints should target 18-36 month bonds. In addition to picking up some additional income, this approach positions portfolios to naturally respond to the threat of a rising yield environment. A year from now, such bonds will have rolled down to mere 6-24 month maturities with lower potential for generating unrealized losses. But importantly, they'll provide a steady source of reinvestment capital. It also buys time to see how economic fundamentals develop.

It will take time for both the (likely) economic recovery and (potential) inflation to develop, and our highest conviction is that the very front-end ought to stay pinned near current levels. We therefore want to focus on the 12-36 month maturity range that coincides with the expected economic recovery.

In these unprecedented times, we remain committed to helping you achieve your cash management goals. Happy holidays and a joyful new year to all.

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