Why wait? Four reasons to consider short-term fixed-income funds

As committed long-term investors, we also recognise the importance of thinking shorter-term sometimes. Higher interest rates and market volatility mean short-term fixed-income funds can serve as an important tool for investors seeking stability and relatively easy access to liquidity in a potentially lower risk setting.

1 . Potential returns are rising in line with money market rates

In response to higher inflation, central banks have been raising interest rates – in Europe to their highest since before the global financial crisis. Short-term fixed-income fund rates track interest rates and so have risen too – also to their highest in years[1]:

- **Money market funds** capture the benefit of rising rates through constant re-investment in funds as they mature.
- **Floating rate notes**, another short-term fixed-income tool, benefit as coupon payments are linked to money market rates.

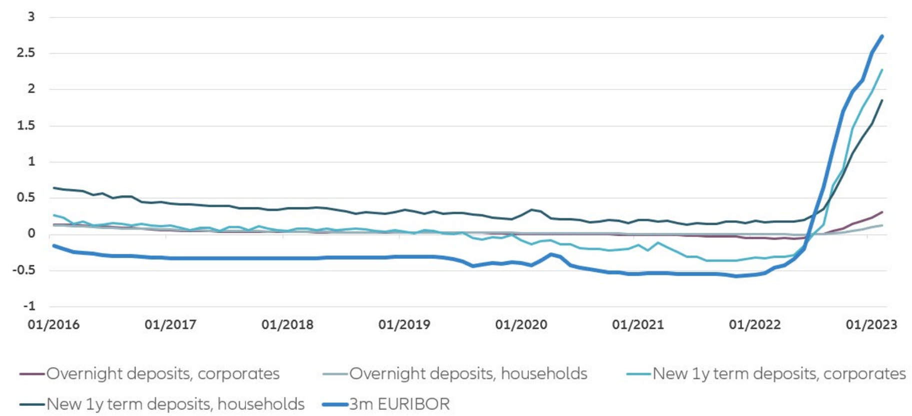
In other words, higher rates mean higher potential returns for investors. And there is still uncertainty about whether central banks have reached peak interest rates yet.

1. Source: Statistical Data Warehouse, European Central Bank. Data as at March 2023.

2. Parking cash in bank accounts may be less rewarding

Bank deposits generally provide investors less return than money market funds. That's because banks have been slow to adjust interest rates on deposit accounts to preserve their interest rate margins. See exhibit below.

Euro zone money market rates vs bank deposit rates for new business (in %)



Source: Statistical Data Warehouse, European Central Bank. Data as at March 2023.

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3. Short-term fixed income funds may provide diversification

Putting money in a single bank account may pose a concentration risk. In contrast, short-term fixed income funds offer broader diversification and can invest in:

- **Money market instruments** – for example, certificates of deposits generally issued by banks offering a fixed term before money can be withdrawn and commercial paper issued by banks and corporates.
- **Government debt securities**.
- **Corporate bonds** – both short-dated fixed rate bonds and floating rate notes.

4. Shorter maturity instruments may offer attractive reward

Higher yield potential: in recent months, shorter-term bonds are yielding more than longer-term bonds (ie, the yield curve is inverted). That's because central banks have been raising short-term interest rates in a bid to contain inflation.

Volatility hedge: thanks to lower interest rate sensitivity, shorter maturities may be able to help shield investors from higher volatility amid uncertainty about the future path of monetary policy.

Learn more: Back to bonds? The new opportunity set in fixed income | Allianz Global Investors (allianzgi.com)

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