**We say Carry on – Don’t stand by Me**

*No I won't, be afraid…No I won't, be afraid*

*Just as long, as you stand, stand by me*

*--Ben E King (Stand by Me)*

*If I'm not back again this time tomorrow, Carry on, carry on as if nothing really matters*

*--Queen (Bohemian Rhapsody)*

*Carry on, my wayward son…There'll be peace when you are done*

*Lay your weary head to rest…Don't you cry no more*

*--Kansas (Carry on Wayward Son)*

When you hear the lyrics to any of the above songs, it’s nearly impossible to not sing along. These are timeless classics! As unusual as it may sound, they can also teach investors a lot about the relationship of bonds and cash in the current interest rate environment.

***Allow us to explain…***

“Stand by Me” is a parallel to the comfort of an old friend…as investors this is CASH. In the last couple of years, investors have piled into short-duration US Treasuries and Money markets because of their principal safety and appealing current yields. The challenge is that this “old friend” is almost certain to disappoint in the next couple of years. While the exact timing remains uncertain, an eventual Fed easing cycle lies ahead. A couple of years from now, that 3-month treasury or money market accounts likely yield closer to 2.5% than 5.5%.

The “Carry” reference in the above lyrics is likely less familiar to most reading this. “Carry” in investment terms can be applied to currencies and trading strategies in fixed income. The specific reference we are making is to an idea of capturing higher cash flow for longer with a combination of bonds with higher yields and a duration component greater than that of cash. History has shown repeatedly that once the Federal Reserve pauses rates, the returns on longer-dated fixed income securities meaningfully outpaces that of cash and short-duration portfolios.

We are absolutely in agreement that a portion in short duration for liquidity purposes and a chance to be opportunistic is logical and prudent. An overweighted cash position can be punitive. Look no further than 2023 for proof. Entering

Calendar year 2023, most expectations for equities and the economy were modest. Most experts expected 2023 to

produce negative equity returns. What happended, instead, was a +26% S&P 500 return and and AGG that slightly outpaced cash. A 60/40 blend of the two outpaced cash by well over 10%! That’s a pretty steep penalty for the “comfort” of cash.

**Our Positioning**

We entered 2023 with a healthy skepticism, but allocated our fixed income in a disciplined way. We weren’t seeking maximum yield. We weren’t seeking a long duration (quite the contrary…our duration is about half that of the Bloomberg US Bond Aggregate Index at present). Instead, we are allocating selectively to managers, strategies, and segments of fixed income that offered a favorable “carry”, modest duration, and strong credit profiles. We remain constructive on securitized debt (think home mortgages) and are paid attractively for the additional risk relative to US Treasuries. We are allocated to high yield selectively and out of leveraged loans.

As we move along in 2024, we expect meaningful rate volatility to persist. The 10-year Treasury could swing between 3.5% and 4.5% for some time. We seek to capture cash flow in excess of money market and benefit from the eventuality of lower short term rates. We look to again outpace in fixed income.

Below is an illustration we feel shows the benefits of having a little credit and a little duration exposure in the mix.



Not only have US markets bounced back following major geopolitical events throughout history, but so too have non-US markets. During each of these events, it seemed that things would never calm, but in each instance they did. As we reflect on the past few weeks, we concede the uniqueness of the Russian invasion and maintain a watchful eye on the situation.