When implemented prudently, borrowing strategies can be an effective complement to asset-based Liquidity strategy solutions. (UBS)

Liquidity strategy: Refreshing yields

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Markets are pricing in a "pivot" in the Federal Reserve's policy; and Fed funds futures are pricing a peak rate of 5.3% in July 2023. This pivot could come even sooner if economic growth shows more signs of weakness, so the UBS Chief Investment Office (CIO) recommends taking this opportunity to revisit your Liquidity strategy implementation choices.

How to implement your Liquidity strategy today

Investors can now get a very attractive yield on Liquidity strategy solutions across the risk spectrum. Although we do expect a couple more rate hikes this cycle, we see a risk that yields could fall precipitously from here—especially if the economy experiences a "hard landing."

With this in mind, we recommend that families continue to lock in higher interest rates—and take on a little interest rate risk—in order to protect against reinvestment risk, which is the risk that maturing investments will need to be reinvested at a lower interest rate. We view the high degree of liquidity and high yields in banking products like savings account programs for needs in the next 6-12 months as attractive—but caution against allocating capital that's earmarked for longer-term needs to such floating-rate products, where falling rates will flow though to lower yields.

Below we will provide a few high-level thoughts to help investors take advantage of the current market conditions.

Bond/CD ladders are at the core of the Liquidity strategy, allowing you to generate income and lock in current yields while immunizing your portfolio from future rate moves, aligning maturities with your cash flow needs. This strategy is ideal for when the timing and amount of your spending is known in advance. Higher interest rates have significantly improved the yield potential of these solutions. For example, a 1–3-year ladder of investment grade corporate bonds currently offers a 5.4% yield to maturity, while a 1-5 year AAA-rated muni bond ladder offers a taxable-equivalent yield of about 4.8%.

As a complement to bond and CD ladders, we recommend investing in satellite strategies to further protect your purchasing power in the Liquidity strategy. These strategies can help you to tap into growth and yield opportunities in exchange for taking on more liquidity, credit, or counterparty risk. Satellite Liquidity strategy solutions also help for investing resources earmarked for spending that is not planned or scheduled ahead of time. We use a Three Tier framework to choose how to allocate to satellite Liquidity strategies:

Tier I strategy assets should be dedicated for your regular operating expenses and "rainy day" cash needs. Bank deposit and sweep account yields have started to trend higher more slowly than other investments, but they remain a crucial part of the Liquidity strategy, offering a highly liquid and safe investment for assets that may need to be tapped at any time. One way to improve the yields in Tier 1 solutions is to consolidate your cash holdings, which can help you to take advantage of higher "breakpoints" for bank deposit and sweep account programs.

In the **Tier II** category, earmarked for known expenses needed in the near future, money market yields have finally started to rise in response to rate hikes. Savings accounts also remain an attractive option, especially for investors with large cash holdings, which may be able to access a higher "breakpoint" interest rate.

In the **Tier III** category, we see significant income potential in the municipal bond market, especially for high income families. For other investors, we see significant opportunities in short-term investment grade corporate bonds. Last, but not least, elevated market uncertainty has enhanced the opportunity set for structured investments, which have the potential to provide investors with attractive returns paired with capital preservation at maturity. Absolute return and market-linked structured investments are among the most attractive offerings in this environment.

When implemented prudently, **borrowing strategies** can be an effective complement to asset-based Liquidity strategy solutions, allowing longer-term investments in the Longevity strategy to continue growing, and reducing the amount of cash drag from safe haven assets during a bull market rally. Inflationary environments tend to be beneficial for borrowers, who benefit from low real yields and are able to repay their loans with depreciated dollars. Although borrowing costs have risen as the Fed has raised interest rates, the return outlook for diversified portfolios has also improved dramatically. To learn more, please see our report: Ask the AI and the experts: Should I borrow to pay taxes?.

Bear market considerations

Because the S&P 500 fell more than 20% from its all-time high, and has yet to recover its losses, we are currently experiencing a bear market. If past bear markets are any guide, diversified portfolios are poised to stage a meaningful recovery over the coming months, with a full recovery within a couple of years.

Therefore, we recommend against raising cash from your long-term investment portfolio to fully fund a 3-5 year Liquidity strategy at this time. If your Liquidity strategy is not sufficiently funded to meet your short- and medium-term spending needs using the asset side of your balance sheet, you should speak with your financial advisor about your options. You may want to consider tapping into borrowing capacity; if you are able to keep a prudent level of portfolio leverage, borrowing may help you to keep your core portfolio fully invested for the recovery. It may also help you to defer potential capital gains taxes. If you do need to liquidate long-term investments for current spending needs, we recommend spreading out these sales as long as possible to give your portfolio more time to recover.

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