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'Forward Returns Are Best When Fundamentals Prevail'

By: David Richman | August 16, 2023

In today's markets, are you capturing referable moments or squandering them? A referable moment is anytime the topic of financial markets, money, retirement, financial plans or legacy pops up in conversation when you are not in the room.

How do you think a client would respond to a friend who proudly proclaims: "Locked in over 4.0% on a two-year CD. Isn't it great sitting in cash these days?" Will they talk about you and how you are helping them? When a referable moment occurs, it either turns into a conversation about you or it doesn't.

So how do you get people talking about you? Work on capturing referable moments by developing and articulating your "isms"—timeless, pithy, soundbites that connect the dots to the advice you are delivering to your clients. We turned to Ralph Hinckley, a portfolio manager and credit analyst on the Floating-Rate Loans team, for inspiration.

> **David:** "Ralph, as you look across the landscape of possible ways for investors to generate income and ultimately, total return, what stands out for you regarding investor comfort with today's relatively higher CD rates?"
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> **Ralph:** "Forward returns are best when fundamentals prevail."
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> **David:** "That's an interesting response and sounds like an intriguing ism."
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> **Ralph:** "We believe this is true for all markets. The technical side of the market (fund flows) often moves on sentiment or headlines and not fundamentals. Such 'technical overshoots' often create fundamental and technical disconnects as the fear gauge kicks in. Returns are often strongest coming out of these technical dislocations. Investors locking in higher CD rates are missing this bigger-picture view."
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> **David:** "Excellent. Let's talk through how you think this applies, particularly to the broader world of fixed income."
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> **Ralph:** "In fixed income markets, technical shifts are often a herd mentality of investors, and they create opportunity for others. In fixed income, these situations usually self-correct within 12-24 months as the fundamental performance of issuers drives the market to see through the noise. This is particularly true in the credit markets that are not based purely on duration. If you are waiting for the all-clear sign, you may have missed the opportunity."
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> **David:** "Ralph, I've often heard you say that starting yields matter. What do you mean by that?"
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> **Ralph:** "For an investor in fixed income, they are often the best predictor of future returns. For years, the return in fixed income was predicated on a multi-decade secular decline in interest rates, with the exception of high yield, which had a credit spread and the benefit of the secular decline and loans, which was based more on the credit spread plus short-term rates."
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> **David:** "As we sit here right now, how low do you think rates will go from here?"

Ralph: "I don't think anyone truly knows. With all the talk of the impact of a decade of low rates and the potential negative consequences of coming out of that environment, it's unlikely we will get back to a zero interest rate policy (ZIRP)."

David: "Ralph, you mentioned the technical side of the market often moves first. How do you control the technical factors?"

Ralph: "We can't. Yet, we always take comfort in knowing the fundamentals always prevail. When people see the actual light of the fundamentals, that's the moment returns start to improve which is why we say: '**Forward returns are best when fundamentals prevail**.'"

David: "How would you connect the dots to our hypothetical friend's proud proclamation about sitting in cash?"

Ralph: "There are higher starting yields elsewhere and as we discussed starting yields matter. Cash is fine for a portion of a portfolio but they will most likely miss capitalizing on the forward returns when the market recognizes fundamentals are prevailing and the 'technical overshoots' self-correct."

Bottom line: Your isms can increase the chances you will organically pop up in conversation when clients are speaking with friends or family, and you are not in the room.

At the Advisor Institute, our goal is not to shape your opinion or provide investment advice, rather to share this viewpoint as an example of what we believe to be a superb display of ism articulation.

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