TRANSCRIPT

Sitting in Cash? How to Get Off the Sidelines

Presenters: Jerome Schneider, John Nersesian, and Heather Knight

Heather Knight: Welcome to the second session of our special event, the Fed Bonds and Your Portfolio. My name is Heather Knight. I'm a national brokerage coach with Fidelity Investments. And in this hour, we're going to discuss strategies for investors who are ready to move cash off of the sidelines and into bonds. And I'm joined today by Jerome Schneider, portfolio manager for PIMCO's enhanced short maturity active ETF, also known underneath the ticker MINT, and John Nersesian, one of PIMCO's head advisor education.

Our friends at PIMCO are a global leader in the active fixed income for over 50 years and have experience helping investors navigate through some of the toughest markets. So we're honored to have them join us today. And we encourage and appreciate questions throughout the session today. So don't be shy in sending those in. So for now, I'd like to turn the floor over to you, John and Jerome, to share a little bit about your backgrounds and to transition right into our discussion today.

John Nersesian: Sounds great, Heather. Thanks so much. We really appreciate the opportunity with our friends at Fidelity, great long-term relationship that our two organizations have had. And maybe most importantly, we're so pleased to have this opportunity to speak to some of the very important Fidelity clients, people who entrust your organization with their hard-earned capital. You do a tremendous job serving as stewards of that capital.

And we're here today to complement that relationship by providing education around a topic that I know is top of mind to many of your clients. John, we're sitting with a lot of cash. We were seduced by those higher short-term rates that came about from the Fed's increase in interest rates over the past couple of years. Now it seems like the table has turned, rates are heading lower. What do we do? How do we think about our allocation to cash and maybe more productive ways to redeploy that money?

We couldn't have a better guest with us. Jerome Schneider is the head of short-term portfolio management at PIMCO. Jerome has an incredibly impressive background. He is absolutely the expert that we want to be hearing from for this particular conversation today.

A little bit about Jerome because he's too modest to talk about himself. Jerome runs the short-term portfolio management suite at PIMCO. That suite encompasses $260 billion of capital. The MINT investment strategy that you referred to, Heather, that particular strategy is celebrating its 15-year anniversary and, I believe, has about $12 billion in capital. Jerome, welcome. Anything that I left out of your impressive bio?

Jerome Schneider: No, other than that, it's a team-based approach there at PIMCO to help manage all these conservative and capital preservation-type strategies. But thanks very much for the opportunity between our partners and obviously yourself, John.

John Nersesian: Our pleasure. And here's what we hope to accomplish today. We're going to talk about cash as an asset class. What is cash? What role does it play in a portfolio allocation? We'll talk about the recent trends that have taken place in markets and the opportunity set that may be before our clients. And then we'll talk about ways in which we can redeploy that cash in a productive and appropriate fashion. We hope that you find it to be educational. We encourage you to provide us with questions so that we can address the issues that are most important to each and every one of you.

Here's our agenda. I'm going to be talking a little bit about the reasons to hold cash, cash as an asset class. Why do we hold it? What are its advantages? And maybe some of the considerations. We'll talk about opportunities to redeploy some of that into other instruments that may provide more productive returns. We're then going to hear from our friend Jerome, who's going to talk a little bit about the current market landscape, what he determines to be maybe the best opportunities to utilize some of this cash in a more productive capacity.

And then we'll talk a little bit about this concept of tiering. Jerome uses a phrase that I really enjoy that not all cash is the same, that we think of cash as a singular asset class. But cash really represents a variety of different opportunities. Jerome is going to educate us about those opportunities in greater detail. And then we're going to end our conversation by talking about a topic that I think has gained a lot of fanfare, the premise of active versus passive investment strategies. Where does it provide value? What are the respective advantages or disadvantages when considering how to redeploy some of your capital?

So let's start first with reasons to hold cash. Here are some questions that we might ask you to contemplate, either individually or maybe with the help of the financial advisor that you're working with. What are your reasons for holding cash today? It's not intended to be a challenging question, but really self-examination. What are some of your current cash needs? After all, cash does provide a couple of advantages. It provides a current yield. It also provides liquidity, which may be necessary during certain obligations that an investor might face.

What are some of your current concerns about redeploying some of that cash, if available in other more productive assets? What about rates? We just heard from Dr. Bernanke. We heard from Dan Ivascyn, our chief investment officer. What are the expectations regarding rates? I understand that the Fed recently took action, lowered short-term rates by 50 basis points. But the question is going forward. How do I think about the trend in interest rates and what opportunities might be available to me?

For those investors who have allocated money to Treasury bills or CDs, what are your plans when these instruments mature? Maybe the reinvestment opportunities are a little bit less productive today than they were a short time ago. How do we think about the available cash that might be coming into our portfolios when these instruments mature? And then finally, what kinds of alternatives might you be considering? Is this cash going to be redeployed in cash? Might you consider extending duration into fixed-income vehicles that would provide a higher yield for a longer period of time? Might they assume a role in your portfolio in other risk assets?

Now, as I mentioned, there are reasons to hold cash. Number one, I've got to provide financial security and some flexibility to meet my current expenditures. If I have a tuition check due next month, I want to make sure that money is available and it's liquid and I'm not assuming market risk that I don't necessarily want to bear. How about unexpected emergencies? Heather and I were just chatting. Heather, you're down in Sarasota, I believe?

Heather Knight: I am, yeah.

John Nersesian: I've got a home down in Naples, Florida. And we know what's heading our way either later today or tomorrow. What if there's capital required to do some improvements or repairs if this particular hurricane or storm winds up causing some damage?

What about tactical opportunities to invest? Cash can play a role in that particular endeavor, providing us with fresh dollars to reinvest during periods of greater opportunity. How about market volatility? We know that stocks as an asset class represents significant volatility with a standard deviation in the mid-teens. Bonds, of course, have a much lower level of volatility. But cash, of course, experiences no volatility, relatively remaining a stable resource to be used when appropriate.

And then, finally, to prepare for known liabilities. I'm going to be buying a second home in a couple of years, John. I plan on buying a new car in a particular period of time. These are the reasons that we would hold cash.

Now, I'm going to talk a little bit about some different risks that cash exposes us to. And I know that sounds like a counterintuitive concept. John, don't you understand? I hold cash because it's considered to be a riskless asset. It doesn't go down in value during periods of market volatility. I've got extreme liquidity. What is the risk that cash exposes me to? Well, maybe there's some subtle risks that I'll address, and I'll ask Jerome to comment on, that investors should be conscious of.

One, of course, is inflation risk. We choose to forego current consumption today, putting aside these dollars into an investment vehicle at Fidelity. And we do that for a very specific reason, to have cash available later on in our lives to meet expenditures. But our goal, our hope is that these dollars that we've set aside have earned a productive return so they can buy similar, if not greater, goods and services when they're needed for redeployment.

How about reinvestment risk? Sounded pretty good when I was getting 5 and 1/4 on my CD three months or six months ago. What do I do now that these dollars are maturing? There is reinvestment risk with short-term instruments that may not necessarily be present with longer-term opportunities.

And then how about a drag on returns? We know that the three primary asset classes that we might consider, in addition to some ancillary alternative investment strategies, are equities, fixed income, and cash. A significant allocation to cash has shown to be a drag on overall portfolio returns. If it's our goal to increase purchasing power, we know that looking at 1-year, 3-year, 5-year 10-year horizons, cash has not done a very good job of keeping pace with inflation, which is why we might consider other alternatives.

Jerome, any other risks or any comments on risk as to why investors should maybe rethink their significant exposure to cash assets today?

Jerome Schneider: The only thing I would offer, John, is that to contextualize the purpose of cash while from an emotional point of view, people like to see a certain amount of cash sitting for safeguarding for those rainy days or for perhaps a purpose in the near-term future, but there is a cost to it. And I think what the purpose of this discussion today is to give you a practical calibration, a practical discussion, and hopefully a template to react to these inflation risks, these potential for reinvestment risks, and more importantly, the drag on returns, bringing up the baseline effect, bringing up the base of what your potential for returns could be.

And we'll give you a simple but very powerful paradigm, a game plan, that allows you to do this later in this presentation. So putting these three things together is very important. The first step is rationalizing how much cash do you actually need for today and tomorrow. And then with the help of Fidelity and tools that we can offer through PIMCO, we can potentially help close that gap and rationalize these three criteria.

John Nersesian: Jerome, I love those comments. I think we often look at cash and the high returns that were available over the past couple of years, the liquidity that is obviously prevalent when we invest in cash instruments, but those benefits come at a cost. And that cost may be missed opportunities to earn higher returns on our available investment dollars. We use cash to prepare for known liabilities and using a simplistic approach.

Maybe it's my goal to buy a car one year out. Maybe three years from now I have a tuition bill that's due at TCU or Lehigh University. Seven years out, I want to buy a second home somewhere. 12 years out, I plan on retiring. And then maybe a longer-term goal of mine is charitable giving or leaving a legacy behind, either for my loved ones or for the causes that I find to be most important.

Let's talk a little bit about fixed income as an opportunity. Jerome referenced it. Here's the idea. I get it, John. I want to go ahead and redeploy this capital. How do I do it? Maybe I'll wait until the marketplace becomes a little bit more clear. This concept of timing, if you will-- and I understand this inherent objective that we all have to time the market to make sure that we get in and out at the right time. But unfortunately, history suggests that market timing more often than not works against us instead of for us.

We need to come up with an allocation strategy that is consistent with our circumstances and our objectives and to allow the markets to work for us. Whether it's in the equity market or the fixed-income market, studies have shown that often investor returns trail the returns of the investment vehicles that they've selected. And it's not because we don't care. It's not because we're not paying attention. It's not because we lack in intellectual ability.

It's the idea that markets are often counterintuitive. When it feels good to make an allocation to an asset class, often that occurs after the asset class has increased in price. And so we have a tendency to chase markets after they've appreciated. And of course, when markets go through their inevitable downturn, we become frustrated and we abandon course. We let these behavioral or emotional issues interfere with the long-term, successful investment program.

Let's take a hold of our emotions. Let's focus on the long term. Let's think about the allocation that we have to various asset classes, making sure that it's consistent with our objectives, but making sure that our capital is working productively for us.

Jerome Schneider: One thing to highlight, John, and in this regard, is that the steady hand, especially even when it comes to cash management, is incredibly important in this point in time. People romanticize the idea of guessing what the next opportunity is, even guessing what the Federal Reserve is going to do at their next FOMC meeting. And yet, the reality is that most practitioners aren't necessarily going to be a Fed funds futures trader. They want to figure out the best way to optimize.

And figuring those situations out, even though we are a professional portfolio managers at PIMCO, is trying to identify structural opportunities. And that investment paradigm that John outlines of staying invested allows you to monetize and take advantage of those dislocations that might only occur a handful of percentage of the time. And more importantly, if you don't actually get the trajectory right of rates or of something of that nature, you might actually miss out on the opportunities.

Cash is the same element here. And we would encourage people, instead of sitting on the sidelines thinking about cash as a one-trick pony, the reality is that we can find our way through a dynamic approach to cash management that allows us to navigate while still being successfully managing our liquidity with a mind and an eye on capital preservation.

Heather Knight: I love that. Both of you just said that, actually, because we have a lot of clients here at Fidelity that talk all the time about, OK, well, so if the bonds that I bought so long ago, they appreciated, is it time for me to sell them? In fact, I think

Kieran, one of our folks in the audience, asked the same question. Does it make sense to sell those and to buy them longer when we think about the terms for those particular bonds? But it sounds like we want to go back to square one and say, what's the objective?

And that really started with everything that both of you just said, which was, let's have our thoughts as to our goals and make it less emotional, even though it'll always be emotional. I think we know that. And then maybe take the next step to figure out, has something changed with why originally did what I did? Has something changed for the future for me? And then maybe take action.

But guess just kind of flat out ask you. So are we saying that if those bonds have appreciated, based on all the greatness that we had with the previous interest rate environment, does that make sense now to change them? I would say no. But I'd argue for the two of you. What would you say to that?

Jerome Schneider: First and foremost, when you heard it in the prior section with Dan Ivascyn, our group CIO, as well as Dr. Bernanke, the reality is that we're just beginning a trajectory of rate cuts along the way. And while the market at this point in time has a set destination in mind, that's perhaps below where the Federal Reserve thinks that destination is going to be and even where PIMCO thinks it's going to be, it sort of haphazard to actually enter a transaction, enter an adjustment to your risk profile based upon that view.

The wind is behind you at this point in time, Heather. The wind being behind you in the fixed-income market means exactly what this chart highlights. Rates fall, prices rise. You want to take advantage and have a mindset that puts you as the investor in the mindset of taking advantage of that tailwind of capital appreciation, bond prices moving higher over the secular horizon. And that's exactly where we are. And that will happen regardless of what we are having happen in the near term with regard to the expectation of rate cuts. Is there a 25- or 50-basis point rate cut at the next meeting? Or what the sequence is. The tailwind has changed.

And so from that perspective, the structural opportunity is out there to take advantage of cash and stepping out of the traditional cash elements of money market funds, Treasury bills. That's what we're really here to talk about. Treasury bills are an investment that mature at par. So that's how we think about the construct that you're exactly highlighting here.

John Nersesian: And that's exactly what this slide speaks to. Thanks for those comments, Jerome. It's the idea that while cash provides liquidity and stability, as Jerome had noted. One of the reasons that we build diversified portfolios, including a variety of risk assets, is so that during periods of market volatility, we have assets in the portfolio that may offset the decline of others. And that's exactly what high-quality fixed income can provide us an opportunity for investors.

We understand this inverse relationship between fixed income prices and interest rates. As rates fall, as they've begun to do, fixed income prices rise. And it's not just the opportunity to lock in a higher current yield through extending duration. It's the idea that I can generate some capital appreciation in my portfolio that may offset the decline of other asset classes during periods of drawdown.

Now, how do we measure this? How do we think about where I belong on that maturity schedule? What is the right duration for me? Well, we need to understand what duration is. Duration, unlike so many of the other metrics that we use in financial management, it's not measured in dollars. It's not measured in percentages. Duration is measured as units of time. And what it essentially answers is if I lend you money, how long does it take for me to get my principal back?

Duration can be used to measure the sensitivity to a fixed-income vehicle relative to changes in interest rates. And so here's the general rule of thumb. For every one percentage point move in rates, a bond price is expected to move an equivalent amount based on its duration. So a one percentage point decline in interest rates for three-year duration bond would expect to see a three percentage-point rise. A longer duration bond, like a 7-year bond or a 10-year bond, would expect to receive or experience a 7% or a 10% increase in price.

Investors need to get comfortable with this concept of duration and how to think about duration, both in terms of the risk that it provides, but also the return opportunity. That's something that Jerome and his team do exceptionally well.

I've got one last slide to cover. And then I'm going to turn it over to Jerome to do some of the heavy lifting. A question that many of you are asking is, well, John, is this the right time for me to deploy my capital? Maybe I'll leg my way into the market. Maybe I'll wait and see as to what opportunities might be present three months from now, six months from now, 12 months from now.

Well, there are some studies done that take a look at that alternative opportunity set. Do I redeploy my capital today with a sensible approach to allocation? Or do I think about legging my way into the market? And if I do so, how might that work? Well, across the past three-year period of time, we look at a variety of different fixed-income sectors, whether it's short term, municipals, core investments, et cetera.

Bottom line, timing the market may not make sense. Jerome, we're going to turn to you to talk a little bit about the current market landscape. You do it every day. You can identify for our friends exactly where you see the marketplace today and how investors might take advantage of it.

Jerome Schneider: Thanks very much, John. What we would say is that the market has definitively transformed itself. And it's transformed itself in a variety of ways. Cash and liquidity is really have been a dominant theme since the global financial crisis. And it's found its way through the increasing amount of cash and reserves within the global banking system.

You can see that in many different ways. But one of the ways we are finding it is more conservative approaches. Simply, that's being dominant by investors, both institutional as well as retail, using money market funds as a tool to manage liquidity, to deploy risk or effectively not deploy risk, and then over time optimize between the different options of income and total return that they see around the markets.

Inevitably, over the past few years, as we've moved from the zero interest rate regime to something more palatable, investors have really moved to those money market funds as they're really the key impetus to capture income, capture yield, capture return, while still being conservative at that point in time. So it should be no surprise to anybody on this call that money market assets under management approaching $6.6 trillion, has experienced 142% of growth over this point in time. That is a tremendous amount of cash on the sideline.

Now, from a practical point of view, we don't expect this to all be risk seeking, move all into equity-seeking type of returns. But there is a vast preponderance of investors, particularly retail investors, who have used the rise in rates to capture that income and utilize money market funds, Treasury bills, Treasury bill ladders as the key and dominant tool over the past year or so to do that.

Now, it's been a fairly straightforward approach. And we would all say that you've done pretty well by simply hanging out in T-bills and buying those T-bills along the way. But as we've noted, there's a few different aspects here to really highlight as we come off the cycle of rising rates, plateaued rates of monetary policy and, more importantly, move to a sequence of reduced rates that's forth coming from the Fed.

Admittedly, the Federal Reserve moved 50 basis points, and things have already started to recalibrate. And there's a few things to note here from a practical perspective. And the question we would ask is, has the insurance policy potentially changed? Has the insurance policy of owning Treasury bills, of owning money market funds potentially changed because of this inflection point in rates?

And so on one hand, you'll have people who will claim that the rates and the front end of the yield curve are still very attractive. And from a nominal perspective and even a recent historical perspective, perhaps they are. But there's two factors to keep in mind here when evaluating the potential returns as we'll go through the next few slides.

Number one, the consequence of earning a return today, as highlighted by a Treasury bill, is going to be relatively short lived. The expectation of the Federal Reserve continuing its rate-cutting sequence is something that's probably going to happen through the end of 2025. The market currently expects those benchmark rates to be somewhere under 3% at this point in time.

So a few things to consider here. The headline returns that you might see in a money market fund today or that three-month Treasury bill yield, which might be attractive, will expose you to reinvestment risk along the way. That's one of the three risks that was highlighted prior to that.

And so what we're highlighting here on this slide is specifically those situations where the Fed has begun that rate-cutting sequence. And as a result, the performance or the expected performance of owning a series of Treasury bills or money market funds over the subsequent year, the return over that year is a lot less than people expected. So you would say if history suggests this-- and we have a couple of examples, empirical examples that do this-- well, why don't people react to it? Well, that's the conversation that we're having here today.

Here is the time to evaluate how you're utilizing your cash, where you're going to be utilizing your cash, and more importantly, how long do you need your cash actually for? And do you have an excess amount? And in this regard, you'll need to be proactive about how you think about utilizing your cash. We'll come back to you here in a second.

So headline discussion is as the sequencing of this Fed, the central banks around the world begins to navigate lower, should you and can you expect to receive the same yields that you've been receiving over the past year? It's unlikely at this point. And as a result, even though there's more of a synchronous harmony and has been for the better part of a decade of all the central banks around the world that provide this opportunity to move in concert with each other, expected policies are going to expect it to be ultimately diverged along the way.

This is going to create different opportunities for investors globally. But here in the United States, we should expect that there is going to be continued rate cuts and cash is not necessarily going to be the beneficiary of it along the way. So the goal? The goal is to take advantage of these falling rates by looking to elongate, looking to have longer returns, by not necessarily relying upon the day-to-day yields, the day-to-day income that a money market fund provides, but accompanying that with some potential for total return, which comes from price appreciation and bonds.

Remember, John highlighted, as bond yields move lower, bond prices move higher. And that's the second component of thinking about the return prospect to put your cash along the way at this point in time. From that perspective, it requires an active approach in terms of thinking about how to navigate your landscape for cash management and to move beyond bills. Knowing that the Federal Reserve will probably continue its easing policy, meaning rate cuts over the intermediate term.

John Nersesian: So, Jerome, your comments make a lot of sense to me. We look at the yield or the return available on Treasury bills, on CDs, on money market funds. But what you're suggesting is it's not just the return that is available, but how long that return will be available for you. I.e., I'm getting a decent return today, but how long is that return guaranteed? And that's why investors might consider other alternatives to extend duration and maybe capture higher yields for longer periods of time.

Let's talk a little bit about the current market environment, Jerome. We've seen this spike in interest rates. Tell us why investors need to be thinking about moving cash into other assets.

Jerome Schneider: Simply put, even though we see a tremendous amount of income generation, if you take a big step back, as we were highlighting in the prior section, when we see the income component of fixed income, it's relatively attractive. One of the things that garnered a huge amount of inflows into money market funds over the past 18 months was the fact could earn returns with relatively little volatility. You weren't assuming the price volatility in the market, whether it was through equity prices or even bond prices at that point in time.

But on a go-forward basis, that's going to fundamentally change. And what we are seeing is a renewed interest not just in maneuvering cash into more active approaches, into short-term strategies like MINT, but across the fixed-income universe to find ways to capture returns and capture total returns with income over a longer period of time that potentially produce lower volatility over the course of a cycle. And that's really where the inflection point of the renewed attraction for fixed income has likely come.

The peak level of interest rates simply recalibrates what tools you're going to use along the way. The easy answer, the easy insurance policy that I referred to before, of being in money market funds is probably no longer the single instrument that you want to be using along the way. It's more diversified in that approach and how you want to think about the opportunity set.

John Nersesian: So I'm an emotional investor. And I'm guilty of all the biases that affect us as investors, one of which is pretty popular. It's recency bias. Jerome, I was very comfortable with that 5.25% I was getting previously. I'm now looking at a new reinvestment opportunity at a lower rate. Tell me why I should or how I should think about this idea that the rate environment is changing and then introduces some uncertainty as to what I do with my money.

Jerome Schneider: Yeah, absolutely. Well, the emotional aspect of how we think about it has a couple of different elements. The first element is the alarm bell, waking up to the fact that rates are moving lower. We see these headlines where rates are moving lower. We're seeing savings rates, deposit rates, certificates of deposit rates drastically recalibrate after the first Fed cut that we've seen. That's a signal to investors that they should begin to think about, is there a better way to manage cash? Is there a better instrument out there?

And that's a situation that we would encourage investors to take a moment and pause, work with your advisors, survey the landscape and then reevaluate. And that's where we are today. Unfortunately, history would also suggest that most investors don't really think about it until 12 to 18 months after the fact that the rate cuts have happened.

And so traditionally, we don't see many outflows from money market fund strategies, specifically from retail investors, until a good 18 months from now.

John Nersesian: This first cut by the Fed, Jerome, is likely to be followed by additional cuts over this cycle.

Jerome Schneider: Well, I would offer that the emotional aspect of how we actually think about the use of cash, which is obviously a security blanket in some regard, also should elicit an equal emotional response, which is, am I actually getting paid appropriately for my cash and liquidity on the sideline? And that should be more of a concern at that point in time.

And what we find is that the inflection point for people having that benefit of having the security aspect of cash to the opportunity cost or the emotional distress of not optimizing their cash actually is pretty great. And what we find is as the Fed begins to cut rates, that difference in return between the reduction in money market fund yields, the reduction in T-bill yields and moving into an ultra-short strategy is worth not just a couple of basis points, but hundreds of basis points.

And that's what you can see by the green bars here is by moving out of cash into an ultra-short strategy, like a MINT ETF or something alike, is the more active approach that allows you to take advantage of the Fed's activity over the course of the next year or the next few quarters.

John Nersesian: So I buy it. I get it. The evidence is pretty compelling that maybe I shouldn't be waiting, maybe I shouldn't be complacent by keeping an overallocation to cash and money market funds or Treasury bills. You talk about this greater return opportunity. Help us understand. How are you doing it? Where's that excess return coming from?

Jerome Schneider: So when we think about it, we want to construct portfolios that have a few things in mind. Number one, we want to take advantage of high-quality assets that are beyond the traditional money market instruments. So as an example, the Federal Reserve was at 5.25% over a long period of time. The average money market fund offered returns of just about 5%. Why is that?

John Nersesian: There a lag there, so to speak, between what the market provides and what I'm getting in my money market fund.

Jerome Schneider: There is a lag, but there's also a cost. And the cost is derived for the market in general, willing to pay a premium through lower yields for the same-day liquidity those instruments provide, that a T-bill provides.

Now, we'll come back to the paradigm in a moment. But as an investor, if you can rationalize it-- you don't need the liquidity today or tomorrow, but you need it over the next few weeks, the next few months, even the next few years. We call that liquidity premium, which means you're going to get paid for effectively looking and knowing that your money doesn't necessarily need to be liquid for cash purposes to pay for your lunch tomorrow but over the intermediate term.

And it's not necessarily locking it up given the vehicle, but you're finding yourself in a situation of paying for liquidity that you don't need to earning liquidity premiums a different way. So said differently, you're earning and using the market to your advantage, given a longer-term horizon for your cash needs.

John Nersesian: Makes a lot of sense. Let's talk about this liquidity tiering. You brought it up. And you used it as a source of alpha or excess return that you're providing to your investors. Can you talk a little bit about those three different tiers that you've illustrated on your slide?

Jerome Schneider: So it's a very powerful slide here. And if you take one thing away from our presentation today, think about this liquidity tiering dynamic. Simply put, the liquidity tiering is how you can access your liquidity over different horizons. And what we find is that investors of all types, institutional, retail, central banks, you name it, typically are overstating their need for liquidity today, tomorrow, in the immediate sense. And we call that Tier 1 Liquidity, what do you need.

And typically, what we find is that investors simply look at cash homogeneously. And in reality, it's not homogeneous. We should be saying, there's a certain cash bucket I need to pay for liabilities tomorrow, and then I have some stuff over the medium term that needs to happen. And so the differential between those is between that first tier of immediate liquidity and the second and third tiers of intermediate liquidity, again, over the next few weeks or the next few months.

Those are not necessarily meant to be same-day liquidity-- although, they can have functionality that way-- but they're meant to provide liquidity over the intermediate term. And to rationalize that, while very straightforward, is something that we encourage all investors to do. We do it at PIMCO through our portfolios. We do it through across the 300 billion of assets that we manage on the PIMCO short-term desk. And we do it by looking at the different opportunity sets and constructing portfolios from the bottom up.

So in doing so, taking that step out of immediate liquidity needs from money market funds of owning T-bills and putting it into a second-tier liquidity strategy, which would be focusing on high-quality ETFs, things like that, allows you to build the platform from high-quality treasuries that you see in the blue part of the pyramid here, moving to high-quality assets which offer some spread compensation. These could be high-quality, asset-backed securities that are triple-a rated, high-quality corporate bonds, self-liquidating commercial paper.

These are all avenues which are, from an institutional perspective, we can find differentiation to produce high-quality portfolios with an average credit quality of double A minus or better for investors. You're not going down in credit quality by taking this approach. In fact, all you're doing is finding different degrees of freedom and running a more diversified approach to your cash management.

And then using our expertise of active management, John, we're thinking about tactical opportunities that can arise due to a variety of situations or changes of liquidity of the broader marketplace. So flexibility is key. But starts out by taking the simple paradigm that's incredibly powerful and tiering your liquidity.

John Nersesian: So it sounds like you've got access to tools that many of us as retail investors may not necessarily have access to or be familiar with. And you can use that larger opportunity set in your understanding of that marketplace. Is that a fair summary?

Jerome Schneider: It's a fair summary. But I think what we want to do is almost utilize resources that the average investor may not necessarily have, in terms of credit research, in terms of structural research, in terms of thinking about broader market liquidity, not just in the United States but around the world.

And effectively, what we would contextualize for investors on this call today is think about that cash management is not a passive pursuit. Cash management is an active pursuit. And it's not an afterthought. So from that point of view, shift your orientation from T-bills, which were incredibly attractive from a yield perspective, to something today to capture the steps of more conservative risk posture, but also the changing navigational landscape of what the Federal Reserve's policy is going to do.

So liquidity moves from being a defensive mechanism to an offensive mechanism, bringing up the aggregate returns of your portfolio over a cycle. That's what we would seek to do today, is reduce the drag on your portfolio.

John Nersesian: I love that comment. And by the way, there's a slide before us. I know Heather is going to redirect us a little bit later to resources that exist within Fidelity, where investors can learn a little bit more about these different strategies or solutions that allow investors to capture that greater return. I loved your comment a little bit earlier.

I spent a lot of time and energy thinking about the equity markets. And I hope that effort is repaid with a higher return. But I don't necessarily do that when it comes to my cash or my short-duration assets.

That brings us to our next topic, talking about active management. And I know that there's this discussion going on. When am I paid by using an active manager? When am I better off using a passive approach? And I know that some of the narrative today is around this idea that active generally underperforms.

Well, that may be true in some equity sleeves, but it's not true in the world of fixed income. And there are a number of reasons why. I'll summarize them and ask Jerome to provide some comments.

Number one, when I invest in equities, the S&P 500, it contains 503 securities. I know that's sounds a little bit interesting to many of you. When I look at the fixed-income world-- and I'm not going to call it the Lehman Agg, Jerome, I'll refer to it as the Bloomberg Agg. The Bloomberg Agg contains over 11,000 securities. So there's a greater opportunity set for an active manager to be selective and maybe produce higher returns because of that.

And that index that might be appealing at a distance, it's important for us to understand how that index constantly changes. With the S&P 500, those portfolio holdings remain relatively stable. There may be an exclusion or a new addition from time to time. But with fixed-income vehicles, they're constantly maturing. And the composition of that index that I've now decided to own in my portfolio, it may not necessarily represent the qualities or the skills that I had determined to be attractive.

I think a lot of our clients would find it to be interesting to note that if we go back to 2008, the great financial crisis, if we look at the Agg as a passive index, it's important to note that the duration of that index has almost doubled over that period of time. And the quality, the credit rating of the securities within has been reduced rather significantly. So let's make sure that we understand what we own. Let's make sure that we understand the opportunity where active management can provide value. Jerome, can you comment on that before we turn it back to Heather?

Jerome Schneider: What we want to do is utilize resources, utilize expertise by not just simply buying something that fills a bucket because it has a certain rating, certain criteria, but look at the relative value opportunities. Look at the credit underwriting. Look from the bottoms up where you can find suitability for your portfolios. And what we find today is that oftentimes there is non-economic reasons that investors buy things. It's easy. It simply fills a bucket because of a certain rating.

But yet, there's structural concerns to be really aware of, macroeconomic policy changes. , Perhaps, geopolitics come into play, changes in liquidity. We're seeing monetary policy change for the first time in a long time. The economy is obviously in a very different place than it was just even two or three years ago. These are all factors that come into play even in cash management, capital preservation opportunities. And the differentiation between different assets specifically might ultimately provide performance.

So one case in point to hit home is the regional banking sector just a year ago or so. And that was very apparent to some people who were focused on balance sheets of those banks, seeing how they were funding themselves. But to a vast majority of the population, the regional banking crisis wasn't necessarily on the radar until we got into March and April of 2023. Those are situations where complacency, or just looking at ratings as an example, might not necessarily lead to an optimal outcome.

And from that perspective, having the technical expertise, incorporating it where you want to have and take risks in a judicious manners allows you to effectively maneuver from a situation where just being passive, even though you might be in a cash management strategy, allows you to be actively defensive in terms of managing your cash. That's really the equation that we want to think about here. And in doing so, you can produce total returns that could be substantial sources of additional return above your traditional T-bills along the way.

John Nersesian: Jerome, we could learn so much more if we had more time from you and your approach to exploring this maybe underexamined asset class. I want to thank you for sharing your expertise with us. I wish we had more time to continue the conversation, but we've got to turn it back to Heather. I think she's got a couple of important announcements to share with our friends.

Heather Knight: I do. I do. And before I let you go-- and thank you both for all of your discussions today. I think that it's really important. And this has been a timely topic, just related to folks just sitting in cash. What do I do next? Have I missed the opportunity? And so I think that hopefully all of us have gotten a little bit more clarity out of this.

But if you're looking to learn a little bit more, from the audience perspective, where can I find out about some of the things on Fidelity or even to expand on the conversations that we've shared with our friends at PIMCO today? There's a great place on fidelity.com. And I think we are going to be adding the links in for folks to be able to see that.

But this is actually one of our landing pages with our friends at PIMCO. And it highlights some of the featured ETFs as well as expanding on conversations and giving ideas to put your cash to work and, of course, tax efficiency, which are conversations that are coming up towards the end of the year, broad exposure. And if we continue to scroll down, there's a great message here as well as some additional information and education related to bonds.

But I'll highlight this real quick because I'd hate for an anniversary to go by without highlighting MINT. You can access MINT from this page directly. And a couple of things that I think that a lot of the folks have been asking about in the audience is like, how do I find out how much it pays? What are the distributions? Fidelity provides you all of that online through our website here.

And so one of the things that I can share with you, in addition to things like composition and basically looking at the objective of each one of these exchange-traded funds, that we do have a section here for distributions and expenses as well. So if you're looking to start the conversation to think about where you're at right now, bring that to your advisor or maybe take a look and say, all right, what's next for me?

What I heard today was we don't want to wait. So it might be time to figure out what your needs are for your short-term cash, and then how I can deploy that to make the most amount of the environment that we're in today.

So with that, I do want to go back to the both of you. Thank you so much, Jerome, for sharing all of your insight with us today. It's been a pleasure to have you on. And John, I'll echo that for you. And I know that a lot of our folks here at Fidelity are going to be excited to take a look at some of the things that we've shared with them today and maybe look forward for another plan.

And then want to thank all the viewers, too. You joined us today. And we appreciate all that time. And we want to make sure that you stay tuned for our next session, which are Bonds are Back. And our friend Danielle Fox is going to be leading a conversation with PIMCO's David Braun and Ken Chambers. And that's going to be more about the opportunities to expanding on actively-managed bonds and making sure that we're giving you as much education as you can in this environment. So we appreciate it.

Jerome Schneider: Thank you.

John Nersesian: Thanks, Heather.

Jerome Schneider: Appreciate it.

Before investing in any mutual fund or exchange-traded fund, you should consider its investment objectives, risks, charges, and expenses. Contact Fidelity for a prospectus, an offering circular, or, if available, a summary prospectus containing this information. Read it carefully.

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Past performance is no guarantee of future results.

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