

Investment Insights



Money Market Funds: Reviewing Their Role in Your Investment Portfolio

Money market funds are effective, well-regulated vehicles that have weathered many financial storms during the past three decades. Despite recent historically low-yield conditions, these funds remain a viable choice for investors who value stability and easy access to their money above all. At American Century Investments®, we believe money market funds are a key facet in a well-diversified portfolio, in addition to stock and bond funds.

Yet, the extraordinary market and economic events of the last 12 months forced many investors to abandon the time-tested strategy of diversification. Maintaining a long-term view has been tough, and many investors sat on the sidelines or overloaded their portfolios with cash-equivalent investments (Treasury bills, money market funds, CDs, bank savings accounts). The heightened demand for these conservative investments, combined with central bank monetary policies, sent their yields to record lows, creating challenges for investors who value income above all else.

Now, with concerns about the recession and credit crisis subsiding, it may be an ideal time to review your overall portfolio strategy. In particular, it's important to determine if your current cash allocation is appropriate for your goals, time frame and overall risk tolerance, and if your cash vehicles themselves are appropriate.

This Investment Insights is designed to offer you assistance as you consider the role of cash in your portfolio.

How did we get here?

In September 2008, the “credit crunch” that followed the subprime mortgage meltdown in 2007 evolved into a full-blown “credit crisis,” which exacerbated the mounting global economic recession. The Federal Reserve (the Fed) cut its short-term interest rate target to record lows to unfreeze the financial system and stimulate the economy. In addition, a massive “flight to quality” ensued, featuring a selloff of riskier assets and soaring demand for quality and stability, pushing yields on the highest-quality cash equivalent investments to record lows.

During the worst of the crisis, several factors threatened the capital preservation and liquidity features of some money market funds. In most cases, the biggest threat to money market funds was their liquidity. Regulators feared a possible financial market freeze-up that would intensify the crisis if investors panicked and tried to liquidate all of their money market fund holdings at once. Fortunately, that panic didn't materialize, and liquidity conditions improved.

Key Points

- ▶ Money market funds continue to be a valuable investment tool for those who value share price stability and easy access to their money above other considerations, and as a key part of a diversified “all weather” investment portfolio.
- ▶ Generating money market fund income is a challenge right now. A historically low short-term interest rate environment has developed in the wake of the credit crisis, the global economic recession, and unprecedented market and central bank responses to these historic upheavals. This low-yield environment is likely to continue into 2010.
- ▶ Money market fund investors seeking more income and/or higher potential returns do have other options that our Investment Consultants can discuss (see pages 2 and 3). Those who have some tolerance for share price changes can consider “moving out on the yield curve” (increasing their maturity exposure) and adding short-term bond funds to their portfolios.

Current conditions create cash conundrum

Investor sentiment has been on the mend lately, and riskier assets, including stocks and high-yield bonds, have rebounded sharply. Yet, investors in high-quality cash-equivalent securities continue to face stubbornly low yields. This scenario owes its existence to central bank, government, and market responses to the credit crisis and global recession. “Significant sections of the financial markets are still functioning largely because of government support and/or accommodative monetary policy from central banks,” says G. David MacEwen, American Century Investments chief investment officer, fixed income.

In particular, the credit crisis prompted the Fed to slash the federal funds rate target to a range of 0% to 0.25%. The Fed’s unprecedented action was designed to stimulate the economy, bolster the profitability of financial services companies, and increase liquidity in the financial system. However, we’re not out of the economic woods yet, and the Fed has stated unequivocally in its recent policy statements it has no plans to raise its rate target anytime soon. Meanwhile, yields for Treasury money market funds are already at rock-bottom levels, and yields for other taxable and tax-exempt money market funds continue to decline, and could fall further, according to our fixed income investment team.

What possibilities could you explore in this low yield environment?

With low yields likely to remain a fixture in the money market arena for months to come, based on recent Fed communications, here are just a few alternatives you might consider if you’re searching for potentially higher returns.

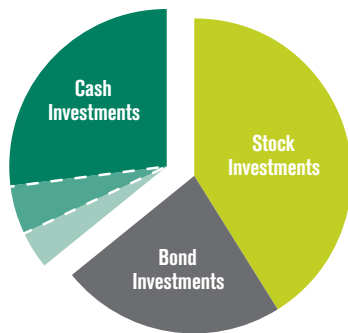
- ▶ **Short-term bond funds.** These funds (which can include core/diversified, government and/or municipal funds) allow investors to do what money market portfolio managers can’t do — move out significantly further on the “yield curve” (increase their maturity exposure) to capture more yield.
- ▶ **Inflation-linked bond funds.** The market’s overall expectations for long-term inflation currently appear too low, given the massive stimulus programs working their way through the financial system. “This suggests inflation-indexed securities represent good value,” says MacEwen.
- ▶ **Stock funds.** Stock prices have rallied off their cycle lows, but they generally remain significantly lower than their former highs. For longer-term investors, certain sectors and securities may represent good value.

The next section, “What kind of money market investor are you?” will help you consider the reasons you invest in money market funds and which are most important to you currently. You may determine that market conditions warrant making an adjustment in your cash investments. We want to help. American Century Investment Consultants can provide guidance and help you evaluate your current portfolio to determine whether or not you should reallocate your assets, develop a market re-entry plan, or maintain your current holdings.

Are low yields affecting your income?

Have market conditions made your cash allocation overweight?

You may need to adjust the cash investments in your portfolio.



This pie chart is a hypothetical example of a diversified portfolio. It is not intended to represent a recommended portfolio allocation.

What kind of money market fund investor are you?

With many investors holding low-yielding and larger-than-usual allocations in money market funds, now may be a good time to review the traditional role these funds have played. They are designed to help you achieve three key goals in your overall strategy:

Capital preservation, or maintaining the value of your investment

Liquidity, or the ability to access your money easily

Yield, or regular distributions of current income

Capital preservation and liquidity were especially important during the market's roller coaster ride that started in 2007. Since then, actions from the U.S. government and the Fed have helped restore some order to the financial markets, and concerns about money market fund stability and liquidity have subsided. Yet, the third feature of money market funds—yield—remains a challenge, given the Fed's interest rate policy and the still-strong demand for the highest-quality securities.

This yield environment raises an important question: How important is yield to you?

When capital preservation trumps yield ... For many investors, preserving value is the primary investment goal, and a heavy weighting to cash alternatives may be an appropriate strategy, regardless of the yield environment. Treasury securities and Treasury-only money market funds still may be the best place to keep your money.

When capital preservation and yield matter... If capital preservation and yield are equally important, and you are comfortable with the credit backing of high-quality corporate debt and bank deposits, consider bank CDs and prime money market funds that can invest in both government and corporate money market securities.

When yield outweighs capital preservation ... If you're willing to sacrifice some price stability in exchange for a higher yield and a potentially higher total return, without sacrificing much, if any, credit quality, you can consider short-term bond funds that invest in government securities. If you can accept a higher degree of volatility—and in some cases, credit risk—in exchange for greater yield and total return potential, consider funds investing in municipal securities, asset-backed securities, corporate bonds, or high-yield bonds.

When longer-term goals prevail ... Those who are less interested in current income but desire diversification away from stocks may want to consider pursuing inflation protection. Funds investing in inflation-indexed securities and international bond funds may foot the bill. You also may achieve inflation protection potential and long-term growth potential from stock investments.

Discover your alternatives.

Now that you've considered your primary investment goals and objectives, let us help you explore alternatives. Review the Investment Viewpoints articles on the business reply form on the back page. You can download or order any of the articles to receive suggestions for various investing goals.

Generally, when interest rates rise, bond prices fall. Inflation-linked securities are subject to factors other than inflation, and therefore subject to interest rate risk. There are specific risks associated with investing in lower-rated debt securities including price volatility, default and liquidity risk.

The opinions expressed are those of the investment team and are no guarantee of the future performance of any American Century portfolio. Statements represent personal views and compensation has not been received in connection with such views. This information is not intended to serve as investment advice.

Find additional answers to your cash investment questions.

The following four articles address common investor questions and provide potential alternatives for your cash investments.

- ▶ Download any of the articles by visiting **americancentury.com** and searching keyword **alternatives**.
- ▶ Return this reply form in the enclosed envelope to order any of them by mail.
- ▶ Call an Investment Consultant (at the number listed on your cover letter) to review money market funds' role in your portfolio.



Name _____

Address _____ City _____ State _____ Zip Code _____

Email Address _____ Phone Number _____

- Investing for Capital Preservation:** Provides a review of the investment alternatives appropriate for investors whose primary investment goal is capital preservation.
- Investing for Inflation Protection:** Highlights the importance of protecting your money from the harmful effects of inflation and reviews the investment vehicles designed to help you achieve that goal.
- Investing for Income:** Provides an overview of the higher-yielding/higher-risk alternatives available to income-oriented investors and how these investments fit in a well-rounded portfolio.
- Investing for Market Re-entry:** Explains the methods by which investors who have been sitting on the sidelines may want to re-enter the investment markets to pursue their long-term financial goals.

By adding my contact information, I understand this constitutes my signature and acknowledges my request to receive solicitations from American Century Investments at the address, telephone number and email address indicated.