Making the Most of Your Money
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Money Market Fund Alternatives

We did not think that interest rates could get any lower, but they have recently as the Federal Reserve declared that it plans to keep its target for the overnight federal funds rate at zero to 0.25 percent for nearly another two years.

That announcement affects us in that we will continue to see very low rates on our money market funds and certificates of deposit (CDs). With inflation running about 3.6 percent (as of July 2011), investors are losing approximately $33.50 in spending power for every $1,000 they have sitting in money market funds. This is because the price of goods and services increases and the values of the money market funds do not.

For many investors who have moved their money out of the stock market and want to sit on the sidelines in a money market fund, this decline in cash's value is disturbing.

So here is a suggestion to consider:

We know interest rates are going to be kept low for the next two years. We also know that long-term interest rates will also be kept low, in an effort to maintain low mortgage interest rates (since bolstering the housing market is critical to our recovery). We face a limited amount of risk by investing in the bond market. With bond investments, when interest rates go up, the values of bonds go down. But in this environment, we feel fairly confident that rates will not be increasing for a while.

You might want to consider putting cash in a short-duration, fixed-income mutual fund. While money market funds have an average maturity of 120 days or less and are allowed to keep their share prices at $1.00 per share, short-duration, fixed-income funds may have maturities of less than two years. Duration serves as a better measure of risk, and so I will use it for now. These funds tend to deliver better yields, not yet above inflation, but a vast improvement over the 0.25 percent you are probably earning in a money market fund.

While there is no guarantee, short-duration funds should remain relatively stable for the next 24 months. Here are a couple of funds you may want to consider. The PIMCO Low Duration Fund (PTLDX) is rated four stars by Morningstar. As of late August 2011, it yields 2.06 percent with a duration of 1.74 years. The T. Rowe Price Short-Term Bond Fund (PRWBX) also receives four stars from Morningstar. As of late August 2011, it yields 2.26 percent with a duration of 1.72 years.

As always, understand what you are investing in and the associated risks.

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