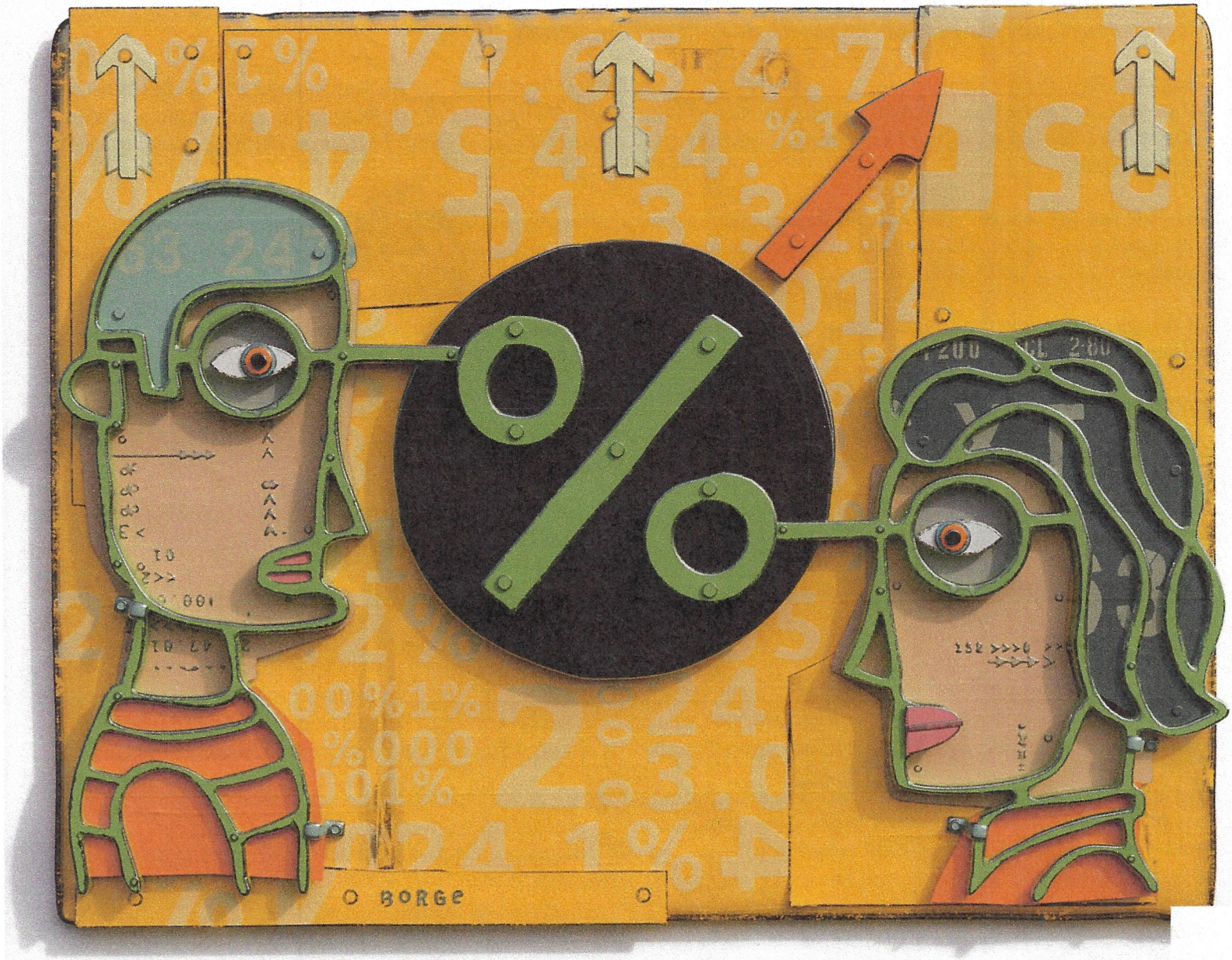
2026-11-1

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FINANCIAL STRATEGIES

Buy money market funds to benefit from rising rates

Translate



While higher interest rates are a complication for stocks and bonds, they are an unequivocal boon if you just want to park some cash and make a little money. Richard Borge — The New York Times

By Jeff Sommer

The New York Times

Rising interest rates have wreaked havoc this year in financial markets.

Yet they are an unambiguous boon in one unheralded arena: money market funds, where the higher rates almost immediately funnel more money to investors without major complications.

This is a big exception to the other major effects of rising rates, which have made plenty of negative headlines because they are a drag on the economy, a burden for people seeking mortgages and a punishing hurdle for stocks. In the bond market, rising rates are a complicated, head-spinning fact of life, setting off widespread losses, though they also promise better returns in the years ahead.

In comparison, money market funds are blessedly simple. If you're holding cash in them or are thinking of doing so, higher interest rates are something to celebrate right now.

That's because money market funds closely follow short-term rate shifts by the Federal Reserve. On Sept. 16, the Federal Reserve raised its short-term policy rate, the Fed funds rate, one quarter of a percentage point, to a range of 3.75% to 4%. Money market rates began moving higher almost immediately.

That said, they didn't jump a quarter point overnight, as the Fed funds rate did. Money market funds are invested in short-term securities like Treasury bills, and it now takes about 36 days for all of these holdings to mature and be completely replaced with higher-yielding investments, according to Crane Data, an independent financial market research firm.

So while money market rates started moving upward soon after the last Fed rate increase, they have continued to edge gradually higher. The average interest rate for the 100 biggest money market funds tracked by Crane Data now stands at 3.71%. It was 3.51% at the end of August.

"If things go the way the markets expect, money market fund rates will reach 4% by the end of the year, and they will keep rising from there," said Peter G. Crane, the firm's president and a longtime expert on money market funds.

Following the Fed

The markets assume that the Fed will raise short-term rates once more this year.

Inflation is likely to stay well above the Fed's 2% target, according to estimates from futures traders, who expect the central bank to keep raising the Fed funds rate to a range of 4.50% to 4.75% by the middle of 2027.

If that turns out to be true, average money market rates can be expected to rise to somewhere close to 4.5%.

Safety Considerations

U.S. money market funds aren't insured by the government, as bank deposits are. If you prefer that greater degree of safety, by all means, keep your money in bank certificates of deposit or in high-yield savings accounts, where interest rates are rising, too. These various bank deposits are insured by the Federal Deposit Insurance Corp.

As a consequence of previous financial crises, including a big one in 2007 to 2009, the rules governing money market funds have gotten stricter. Most money market funds for individual investors now hold government securities — mainly Treasury bills, which are backed by the U.S. government — instead of commercial securities, which are deemed to be riskier and are held by so-called prime funds.

I view big government money market funds run by large financial institutions as quite safe and keep most of my cash in them.

Money market funds are a form of mutual fund. As with stock and bond mutual funds, fees matter. Assuming the funds are invested in essentially the same underlying securities, lower fees mean higher returns, so check fund fees closely.

Vanguard, the low-cost leader in the mutual fund business, offers money market funds with fees ranging from 0.07% to 0.12%, a level that serves as a reasonable point of comparison, if you are shopping around. (Because my workplace retirement accounts are run by Vanguard, and Vanguard fees are low, the convenience of sticking with one place has led me to use Vanguard for money market funds, too. But your own situation may dictate other choices.)

We're not talking about making great fortunes here. Money market funds don't do that. They generate modest returns.

At the current average 3.71% rate for large money market funds, for every $10,000 held for one year, you would receive $371. That's no bonanza. (Vanguard's Federal Money Market Fund's yield is a little better, 3.84% on Friday, generating $384 for one year, at that rate.)

It's better than the nearly nothing you would receive in a standard checking account. But in comparison with a hot stock, the returns from a money market fund are so small, they are barely visible.Over longer periods, though, the situation is different. Longer-term bonds tend to outperform money market funds precisely because bonds carry higher yields as compensation for the risk of holding them for longer periods. That's why it makes sense to hold bonds and bond funds for long-haul stability, and to use money market funds as a place to keep cash for paying the bills and emergencies.