Cash is King?!?

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Surprisingly, the equity markets have surpassed their pre-pandemic levels. The US Equity Market (the Standard & Poors 500 Index) is up 5.6% year to date. Bond and cash yields have collapsed, and rates are like those of the 2007 to 2010 Great Recession. What is an investor to do? And what is the place for Cash and Bonds in a portfolio? What about Emergency Funds? Is there a different approach needed for retirement?

Currently, all US Treasuries maturing with the next 10 years are yielding less than 1%. If there is any inflation in the next few years investors will not be keeping ahead. And rates on cash, money market funds and Certificates of Deposit are also extremely low. For example, $100,000 in a savings account will earn, if you are lucky, $220 in interest for 2020. One reason bond yields are low is that there is high demand for safe assets (such US Treasuries) and this drives up the price of the bond. When bond prices go up the yield goes down. Demand for these 'safe assets' increases in times of uncertainty.

In addition to providing income for portfolios, historically bonds and cash have served as a shock absorber for portfolios. This continues to be the case now. For individuals in retirement, we setup portfolios to have 3-5 years of withdrawals available in bonds and cash to withstand any long draw down (drop) in equity markets. We often will use laddered Treasuries for this purpose. A Treasury ladder consists of bonds with different maturity dates to cover the time period involved. Now because of low rates we have also been using corporate bond funds that mature in a specific year.

We also utilize core bond funds in portfolios and occasionally, we will invest in a bond fund for a specific concern. Core bond funds are funds that invest in a broad set of investment grade bonds. For one client wanted to make sure that she had money available in case she needed to buy into a retirement facility. We used a bond fund for that purpose and pointed out the amount invested to her when we met.

As a rate comparison, the Standard & Poor's 500 Index is now yielding 1.8%. This rate is slightly below the average of the last 25 years (2.2%). Of course, equities have higher risks in the short-term. Pundits have nicknamed this market a TINA market. TINA stands for There Is No Alternative (to Equities). Some individual corporate bonds are yielding lower than the company's stock dividend. For example, you can purchase a bond from Coca-Cola maturing in 2031 that pays an interest rate of 1.375% or you can purchase the stock and it yields 3.3%.

One silver lining in a low rate environment is the opportunity to refinance debt or purchase a new house. Mortgage rates are likely to remain low for a while. The average rate on a 30-year fixed mortgage is 2.8%, near its lowest level in over 50 years. These low rates combined with COVID-19 pressures have led to the housing market being strong. There is a lack of houses for sale now – which is causing prices to rise. The work from home and work from anywhere trends are adding to demand in certain areas of the country. Large cities, however, are seeing an exodus as households are wanting more space.

Consumer spending has begun to recover from the depths of earlier this year. And there are several economic tailwinds that could help the economy going forward. These tailwinds include the housing boom, increased household savings rates, cash buildup at institutions, and pent up demand. The housing boom will lead to purchases of appliances, furnishings and other household items. Overall, household saving rates have improved significantly over the past six months. And institutions (financial mostly) have been accumulating cash and not investing it. For example, in the first half of 2020, more than $980 Billion has flowed into money market funds (and $140 Billion out of Stock Funds). This increased cash on the sidelines may come into the equity markets as election and corona virus uncertainty decreases. This will provide a tailwind for equities and for the economy.

It is often difficult to have your cash and bonds 'sit' on the sidelines not earning much interest. However, cash and bonds have many roles in an investment portfolio. One role is to serve as an extra emergency fund that is separate from what might be held locally. Another is to be ready for better investment opportunities. A third role is to serve as a portfolio shock absorber for when the equity markets are in distress there are still funds available and the drops in the portfolio are moderated. Overall, it is important to keep in perspective your individual situation and what your goals are and then to consider the role of cash and bonds for your portfolio.

"Cash combined with courage in a time of crisis is priceless." – Warren Buffett

"When people talk about cash being king, it's not king if it just sits there and never does anything." – Warren Buffett