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INSIGHTS

CASH-FLUSH AMERICA

As Q2 US corporate earnings season winds down, the U.S. Bureau of Economic Analysis (BEA) reports that Q2 profits were up 9.2% from Q1 and up 15.8% from the pre-COVID peak in late 2019. These profits are showing up in corporate cash balances.

Taking the Federal Reserve's most recent money-supply data and stripping out the estimated level of demand deposits from corporations and institutional money-market accounts, analysts calculate that households and small businesses have stockpiled a record of almost $17 trillion! For context, that estimate exceeds the International Monetary Fund's estimated $16 trillion in fiscal action undertaken by governments around the world to keep the global economy afloat during the pandemic.

Analysts believe that cash hoard has grown exponentially since February 2020 due to three factors:

1. direct government stimulus payments to individuals,
2. shutdown-induced savings from Americans working from home,
3. small-business decisions to hold onto grants or loans.

The magnitude of the cash positions being held is surprising considering the tendency of households and businesses to tap their savings during prior recessions. After the coronavirus pandemic triggered a deep two-month U.S. recession starting in February 2020, what is different this time around is that savings have soared despite the economy reopening. Two reasons have been offered for this:

1. small businesses appear to be focused on rebuilding inventories to brace for pent-up demand,
2. individuals are opting not to spend any more money on the restricted services and experiences that have now become the norm.

According to the Investment Company Institute (ICI), as of August 25, investor money-market balances totaled $4.5 trillion. In addition to representing spare cash that could still come into equities, this money is acting as a "barbell", allowing investors to avoid selling off equities to meet cash requirements.

This cash on the sidelines also partly explains why the equity market has not suffered a 5% pullback for over 200 days now – any pullback is seen as an opportunity to put cash to work in a low interest rate environment.

September is historically a weak month for stocks, so it would not be surprising, given a market trading at all-time highs, that any hint of another Covid wave or indication of stubbornly high inflation may spark a market selloff. However, companies are not paid to hoard cash, especially

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in this low interest rate environment. They either have opportunities to invest the cash to earn a higher rate of return, or if they do not see any immediate opportunities, to return the cash to shareholders in the form of dividends. In the first scenario, investing in new projects is good for the economy, in the second scenario equity holders receive an attractive dividend. Given the scarcity of investment opportunities in the fixed income market, expect any selloff to be short-lived as the trillions of sidelined dollars look for an opportunity to participate in corporate investment growth or relatively attractive dividend yields.

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