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Cash is not king

Evidence proves that market timing does not work

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Personal Finance

Since the presidential election, interest rates have been rising, but rates paid on savings at banks are still near historic low levels, barely more than zero percent. Big losses have been suffered on holdings of intermediate and long-term bonds, as that is where the rates have risen the most. Losses on 10-year treasury bonds are approaching 10 percent since the election. Prices on bonds go down when rates go up. As of this moment the stock market has gained nearly 10 percent since the election.

Prior to the election, cash held by portfolio managers stood at levels not seen in more than a decade and month after month that amount was growing. No one can accurately predict the future, and the outcome of the election was a surprise to most. Polls prior to the election asked which candidate would be better for the stock market, and those polls chose Hillary Clinton. The expectation was that a continuation of current policy from Washington would keep the bull market going.

So far, the change promised by Donald Trump sparked the strongest year-end rally in years, contrary to what polls led many to believe was likely. A post on social media the night of the election bragged about selling everything weeks before the election anticipating a Trump victory. Hopefully, no one took that post as advice to sell the next day.

Imagine having the foresight to invest just before the markets started to rally the day before this recent Election Day and then liquidate all holdings at the peak whenever that day comes. Or just before a major losing year in the market like 2008, selling your holdings and waiting until the market hits rock bottom, and then investing to enjoy all the gains you earned. Market timing like this just never works, as there are no reliable indicators that give consistent clues of market tops and bottoms.

Even if the decision to sell prior to a correction is timed right, it is unlikely the decision to buy back in will be well-timed.

Holding cash is the wise move if funds are needed in the near term for a planned purchase like a car, college tuition or home, and holding cash to cover living expenses for the current year or at least part of the current year is not a bad policy. Holding emergency funds is a common practice. These are times when risk should be avoided.

But holding cash for extended periods of time, especially when those funds are not needed in the near term, is a costly mistake.

In practice, many people hold large amounts of their portfolio in cash, and in some cases cash is their only investment. Cash includes liquid money funds, savings accounts and short-term certificates of deposit. Holding cash in large amounts as an investment applies not only to small investors. Many banks have divisions to help investors with minimums of half a million or more in cash and some set the minimum at $5 million or more.

The reason for holding so much cash is usually either fear of losing principal or waiting for the right time to invest. With proper education, these investors can earn much better rates of return on their money than staying in cash for extended periods of time.

Evidence proves that market timing does not work. And long-term investors have always been rewarded by prudently participating in the markets. There are many great investments in companies that pay steady dividends and grow those dividends to keep pace with inflation. If you are one of those sitting on a large portion of your portfolio in cash thinking "cash is king," maybe you want to talk to an advisor to be educated about your options.

Start investing with the understanding that "cash flow is king." This cash flow comes from dividends paid from individual stocks or interest paid on individual bonds. The income derived from dividends and interest can be reinvested, or it can be used for funding various lifestyle needs. Keeping cash "safely" in the bank misses the improved income and growth opportunities that more experienced investors are able to enjoy. NHBR

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