HOW MUCH IS TOO MUCH CASH ON THE SIDELINES?

By: John Ludlow, CFP®, Vice President, Senior Financial Planner

Financial security is top-of-mind with almost everyone these days – after all, the world has been through a lot recently, and we may not be out of the woods yet. Regardless of where we've been and what lies ahead, it's always comforting to know you have cash on the sidelines to tap into when you need money.

However, if you've been hesitant to invest over the past year or simply haven't gotten around to it, you could be at a disadvantage. The downside to stockpiling cash in low-return investments over the long haul is that it can cause you to fall behind financially by diminishing your portfolio's investment returns.

CASH HAS ITS TIME AND PLACE

It's important to have some cash set aside for emergencies, large purchases or unexpected employment disruptions to help keep your lifestyle intact if you need to rely on your savings. At the same time, you want to be careful to not have too much cash in lower yielding accounts. Why? Because any funds you keep outside of your managed investment portfolio will limit the growth you need to fund your long-term goals. This growth will be key to supporting your future lifestyle, pay for a child's college education, and fulfill your retirement dreams. However, there are times when some cash on hand is an important strategy.

Emergency fund. The cash you're saving in bank accounts, money markets, CDs, T-Bills, etc. is good for the short term since these holdings are exposed to very little investment risk. Unfortunately, these accounts tend to earn very little interest. Typically, these assets are thought of as an emergency fund that can tide you over for six months to a year and be quickly and easily accessed to pay bills in case of a job loss, reduced income, natural disaster, or major illness.

Large purchase or expense. If you have a major purchase or expense looming on the horizon, e.g., taxes, a new car, major home repairs, or even buying a new house, you should set cash aside. Investing money that you know you will need soon could expose you to market losses and reduce your ability to pay for the large purchase or expense if the market declines before you need access to these funds. Having cash reserves allocated for these large-ticket items may help you avoid the impact of market losses.

Employment issues. As a result of the economic recovery, the job situation in our country seems to be on everyone's mind these days. From corporate board rooms to dining room tables, America is trying to figure out how, when, and where to work going forward.

CAN YOU SAVE TOO MUCH?

When it comes to saving for a rainy day, Americans are putting money away at a historically high rate. The pre-pandemic savings rate of the average American worker was approximately 7.3%. However, as of March 2021, the personal savings rate in the U.S. had risen to a whopping 27.6% – nearly four times the pre-pandemic savings rate.

According to Crane Data, as of January 2021 nearly $17 trillion was held in money market funds, bank savings accounts, and certificates of deposit (CDs) – a 24% increase from the beginning of last year.[1]

We all have different factors that would affect our ability to find new employment or become self-employed if our current way of earning a living disappears. If you work in a field where it may be difficult to find a new job quickly, you may want to increase the amount of your savings to allow you the time you need to find new employment. Business owners may want to increase their savings substantially to account for slow business conditions or a worst-case scenario where you must close your business for good. (However, if you enjoy a two-income household, perhaps you may not need as much in savings to support your lifestyle if only one income stream is lost.)

KEEP YOUR EYE ON YOUR LONG-TERM GOALS

While cash in an emergency fund can help you survive occasional financial jams, it really shouldn't play a large role when it comes to investment accounts meant to fund your long-term financial goals. Too much cash on hand or wealth parked in low-return assets can substantially diminish your investment returns and become a "portfolio drag" (earning less on your money by playing it too safe).

Trying to time the market and running to the perceived safety of cash can also hurt your financial situation in the short term. If you pulled money out of the market last spring when the S&P 500 suffered its quickest-ever 20% drop only to mount a rapid rebound, you lost out during the recovery period by not staying invested in the stock market. If you're still sitting on the sidelines waiting for the right investment to come along, you're missing out this year too. The U.S. stock market has risen to record levels in 2021 thanks to the vaccine, strengthened economy, fiscal stimulus, and the Federal Reserve's accommodative monetary policy.

BEING TOO CONSERVATIVE CAN BE COSTLY

When inflation enters the picture, being too conservative can be costly. Cash, which today pretty much yields zero, loses purchasing power and generates a negative return when you factor in consumer inflation.

For example, if you have a $5 million all-cash nest egg and have annual expenses of $250,000 that increase 2% per year because of inflation, you'd have only $2.5 million left after 10 years of drawing down the cash to meet your bills and expenses. If you had invested that same amount in stocks, the value of your portfolio could be expected to rise in value to $7 million over the same 10-year time period.[1]

Investors seem to be getting the message, according to a recent investor sentiment survey. In April 2021, 41% of investors surveyed were thinking about boosting stock exposure in their portfolios in the next six months – with 70% citing industries being transformed by technology as a top opportunity. Furthermore, 64% believe stocks are an effective way to diversify portfolios during the economic recovery. U.S. investors were found to be the most upbeat globally, with 70% expressing optimism compared to 52% three months earlier.[2]

PORTFOLIO LOANS

If you need more cash than you have available due to an emergency, large expense or employment issue, a securities-based line of credit may be a good option. It can generally be established quickly and typically at a lower interest rate than other loans.

WE'RE HERE TO SUPPORT YOUR CASH COMFORT LEVEL

Your decision regarding how much cash to hold in savings depends not only on your comfort level but also other varying factors that we have already discussed. While cash is nice to have on hand, it's important to invest a portion of your portfolio in the stock and bond markets for your long-term financial needs and goals.

If you're sitting on excess cash and trying to get back on track with your investment strategy, contact Commerce Trust Company today. We can help you determine the right financial strategies for your budget, lifestyle, and retirement.

[1] Adam Shell, "Yes, You Can Have Too Much Cash," Kiplinger, https://www.kiplinger.com/investing/602852/yes-you-can-have-too-much-cash, May 27, 2021.

[2] UBS Investor Sentiment Survey, UBS Global Media, "UBS Investment Sentiment survey: Cash holdings remain high but investors plan to buy stocks," https://www.ubs.com/global/en/media/display-page-ndp/en-20210428-investor-sentiment-survey.html, 28 April 2021.

General Source: www.marketwatch.com, "Investors are still keeping their cash levels high – but here's what's drawing them to stocks, UBS says," https://www.marketwatch.com/story/investors-are-still-keeping-their-cash-levels-high-but-heres-whats-drawing-them-to-stocks-ubs-says-11619560303, April 28, 2021.

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John is a financial planner for Commerce Trust Company. He is a member of the financial advisory services team, a dedicated financial planning practice within Commerce Trust that provides objective financial advice to clients. Following a thorough assessment of a client's unique situation and thoughts regarding wealth, John develops holistic and coordinated plans to help clients meet their short-term and long-term goals as well as take full advantage of various planning, tax and investment strategies along the way. John has nearly 25 years in the financial planning industry, working with both individual and institutional clients. John received both his bachelor of science in business management and master of business administration degrees from Brigham Young University. He has also earned his CERTIFIED FINANCIAL PLANNER™ designation.