

Naviter Note
April 2022

With the uncertainty and market swings of the past few years, it's understandable that some investors would seek the safety of cash. On the surface, holding cash means not having to cope with the ups and downs of the stock market due to the pandemic, global conflicts, rising interest rates, the Fed, and more.

However, this is only true over the shortest of timespans. Over months, years and decades, the value of cash is quietly eroded by inflation, and the missed opportunities of not being properly invested can add up. This is why, for long-term investors, managing behavior and emotions is just as important as managing portfolios. Doing so helps investors stay on track to achieve their financial goals, while helping them to sleep well at night too.

There are three main problems with sitting on cash today. First, high inflation - the worst in four decades - is eroding the value of cash, especially when it sits in a regular checking or savings account. By not earning a sufficient level of interest or generating a return, the purchasing power of one's hard-earned money falls each year. According to the Consumer Price Index, energy costs have increased more than 25% over the past year, food price nearly 8%, the cost of shelter 4.7%, medical care services 2.4%, and so on. Even as inflation rates settle down, this corrosive effect will no doubt continue.

This is the hidden cost when investors seek the safety of cash. The balance on a bank statement may feel safe since it is stable, unlike the fluctuating value in an investment account. However, what matters isn't the dollar amount of cash but what it can purchase. Inflation means that the same number of dollars buys fewer goods and services each year, even when the number remains the same. Thus, portfolio growth is needed to keep an investor's purchasing power at par, let alone to create real wealth.

The second problem is that cash and savings accounts still generate little to no income, even with medium and long-term interest rates rising. As of March, the national rate for a 12-month CD was still only 0.14%. In other words, locking up \$10,000,000 of cash for 12-months would only yield \$14,000 when inflation would have eroded its spending power by \$80, based on the Consumer Price Index. In this example, the real inflation-adjusted rate is what matters.

Additionally, Treasuries with the shortest maturities still yield very little relative to long-term rates, and it will take time for savings accounts and Certificates of Deposit (CDs) to catch up. The 3-month Treasury yield has risen to 0.7% but this is still well below its 10-year peak of 2.45% in 2019.

The picture is very different for other parts of the bond market. The yields on Treasuries, mortgage-backed securities, and corporate bonds are now above their historical averages. Investment grade bonds, for instance, now generate 3.9% per year compared to their average of 3.4% since 2009, and 2.2% one year ago. Of course, investing in corporate bonds and those with longer maturities involves risk, especially as interest rates rise. This is why it may be important to build a portfolio using diversification, laddering, and other tools, ideally with the support of a tenured fixed income manager.

Third, for those saving and investing to achieve financial goals, shifting a portfolio to cash may provide short-term comfort but will most likely jeopardize long-term gains. Finding the right balance between resisting the urge to react to short-term news, while taking advantage of the long-run growth of the market, is the biggest challenge all investors face.

For professional investors, cash is simply another asset class with particular characteristics that can be combined with stocks, bonds, alternatives, and more. The right mix that takes advantage of all asset classes can achieve a much better balance of risk and reward. This is the preferred way to manage portfolios while improving investor confidence and avoiding the urge to time the market.

Ultimately, cash is an important part of any portfolio if used appropriately and in moderation. Having the discipline to save enough cash in the first place is the first step toward financial freedom. Investing that cash in the right portfolio is what grows savings into real wealth. Below are three charts that put the value of cash in perspective.

The bottom line? While cash can be alluring, rising inflation means that staying diversified is likely to be a better approach.

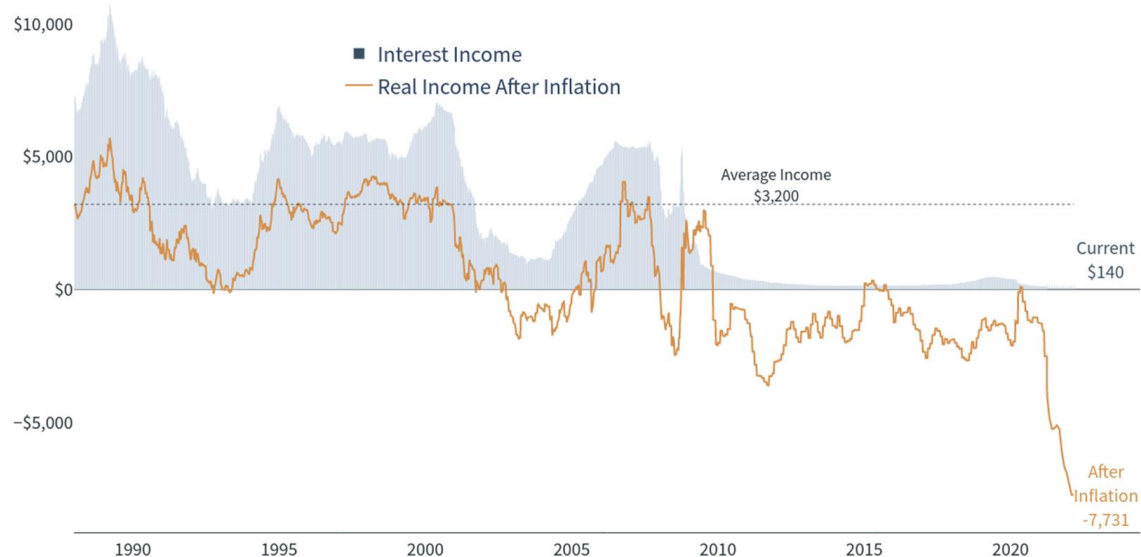
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Interest Rates

Interest Income on Cash

\$100k invested in 6-month CDs against inflation. Actual rates may vary



Latest data point is Mar 2022

Source: FDIC

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While cash is attractive when markets are scary, its value quietly erodes over time.

Many investors are drawn to cash when markets are volatile. However, the challenge with cash is that it doesn't protect against inflation. Even savings account and CD rates are still at historic lows despite rising interest rates.

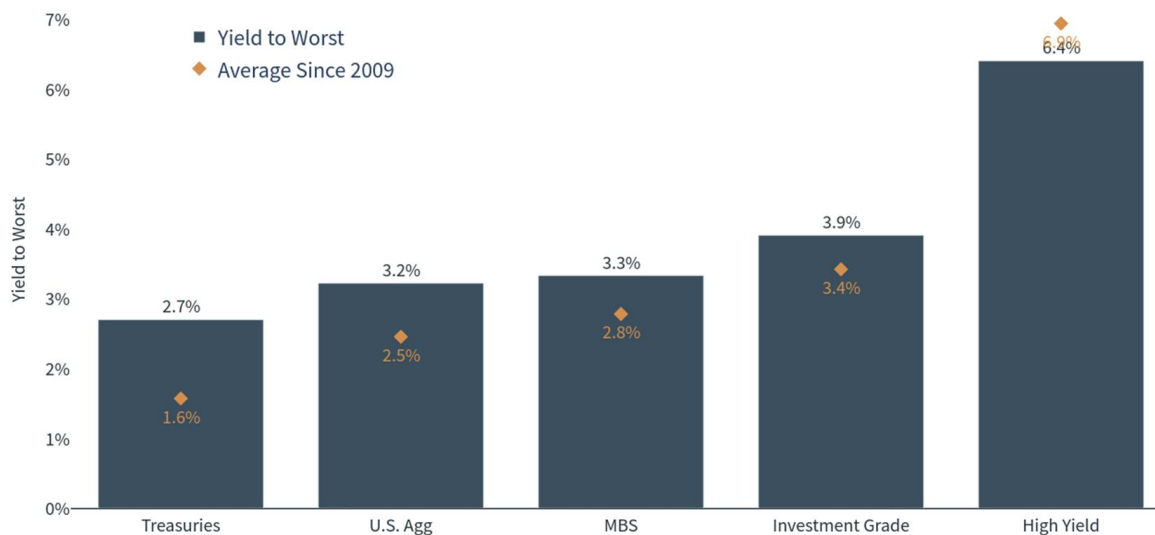
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Fixed Income

Traditional Sources of Bond Yield

Yield to worst and averages since 2009



Latest data point is Apr 8, 2022

Rising bond yields make savings accounts less attractive.

In contrast to savings accounts, bond yields for government and corporate issues are rising. In many cases, these yields are above their historic averages.

Source: Clearnomics,
Bloomberg
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Asset Allocation

Asset Class Performance

Total Returns

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
EM 32.6%	EM 39.8%	Fixed Inc. 7.9%	EM 79.0%	Small Cap 26.9%	Fixed Inc. 7.7%	EM 18.6%	Small Cap 38.8%	S&P 500 13.7%	S&P 500 1.4%	Small Cap 21.3%	EM 37.8%	Fixed Inc. 0.1%	S&P 500 31.5%	Small Cap 20.0%	S&P 500 28.7%	Commod. 27.6%
EAFE 26.9%	Commod. 16.2%	Balanced -22.5%	EAFE 32.5%	EM 19.2%	S&P 500 2.1%	EAFE 17.9%	S&P 500 32.4%	Balanced 6.4%	Fixed Inc. 0.5%	S&P 500 12.0%	EAFE 25.6%	S&P 500 -4.4%	Small Cap 25.5%	EM 18.7%	Commod. 27.1%	Balanced -5.2%
Small Cap 18.4%	EAFE 11.6%	Small Cap -33.8%	Small Cap 27.2%	Commod. 16.8%	Balanced 0.6%	Small Cap 16.3%	EAFE 23.3%	Fixed Inc. 6.0%	EAFE -0.4%	Commod. 11.8%	S&P 500 21.8%	Balanced -4.9%	EAFE 22.7%	S&P 500 18.4%	Small Cap 14.8%	S&P 500 -5.5%
S&P 500 15.8%	Balanced 8.4%	Commod. -35.6%	S&P 500 26.5%	S&P 500 15.1%	Small Cap -4.2%	S&P 500 16.0%	Balanced 15.9%	Small Cap 4.9%	Balanced -1.5%	EM 11.6%	Balanced 15.2%	Small Cap -11.0%	Balanced 20.4%	Balanced 12.6%	Balanced 14.0%	EAFE -7.5%
Balanced 13.0%	Fixed Inc. 6.6%	S&P 500 -37.0%	Balanced 21.1%	Balanced 12.2%	EAFE -11.7%	Balanced 11.2%	Fixed Inc. -2.0%	EM -1.8%	Small Cap -4.4%	Balanced 8.0%	Small Cap 14.6%	Commod. -11.2%	EM 18.9%	EAFE 8.3%	EAFE 11.8%	Fixed Inc. -7.8%
Fixed Inc. 3.9%	S&P 500 5.5%	EAFE -43.1%	Commod. 18.9%	EAFE 8.2%	Commod. -13.3%	Fixed Inc. 3.8%	EM -2.3%	EAFE -4.5%	EM -14.6%	Fixed Inc. 2.4%	Fixed Inc. 3.6%	EAFE -13.4%	Fixed Inc. 8.5%	Fixed Inc. 7.5%	Fixed Inc. -1.8%	EM -8.0%
Commod. 2.1%	Small Cap -1.6%	EM -53.2%	Fixed Inc. 3.0%	Fixed Inc. 6.4%	EM -18.2%	Commod. -1.1%	Commod. -9.5%	Commod. -17.0%	Commod. -24.7%	EAFE 1.5%	Commod. 1.7%	EM -14.2%	Commod. 7.7%	Commod. -3.1%	EM -2.2%	Small Cap -10.9%

Latest data point is Apr 8, 2022

The Balanced Portfolio is a hypothetical 60/40 portfolio consisting of 40% U.S. Large Cap, 5% Small Cap, 10% International Developed Equities, 5% Emerging Market Equities, 35% U.S. Bonds, and 5% Commodities.

Source: Clearnomics, Refinitiv

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Diversified portfolios have performed well over time.

For investors who prefer cash to protect their portfolios, holding diversified assets is often a much better approach. Not only does this protect investors on the downside, but it helps to generate long-run growth.

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April 2022 Naviter Note Contributions:

- Liu, John. Email to the author. 11 April 2022.
- Blackmon, B., Kornet, J., Worthen, P., Bauer, J. (Naviter Wealth)

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