LAMCO
LAMCO ADVISORY SERVICES, INC.

# PUTTING A TARGET ON CASH
## COULD BE A PRUDENT INVESTMENT STRATEGY

**By Mitchell Lamoriello | Research Analyst**

**High-net worth investors hold about 22% of their assets in cash and cash equivalents, according to Capgemini's 2018 HNW Insights Survey. That's greater than their fixed-income allocations, and it's approximately equal to their real estate and alternative investment allocations *combined*. Cash allocations are even larger for affluent investors overseas. The global average stands over 27%, and runs about 45% in Japan!**

By comparison, the American Association of Individual Investors, which represents a broader cross-section of net worth, reports that cash allocations have fluctuated between about 13% and 17% since the beginning of 2017. Affluent investors not only have more assets, but they keep a greater share of them in cash.

There are two opposing views that govern how we should think about cash allocations:

---

- Readily accessible cash is a corner stone of every prudent financial plan. There's no universal target allocation—an investor with more capital-intensive risks, like real estate or business investments, may need to hold a greater proportion of their assets in cash than someone invested primarily in securities. Those relying on their investments as a source of income may also need to hold more cash than an investor with a day job.

- Cash holdings inevitably dampen investment returns. Un-invested assets don't generate gains or losses in the traditional sense, but they produce opportunity costs in the form of lower overall returns in rising market environments and shallower losses in downturns. Furthermore, cash allocations are especially susceptible to the erosive impact of inflation.

Affluent investors can reconcile these realities by calculating the *right amount* of cash to hold and developing a deeper familiarity with cash management techniques. The first step is to ensure they're not over-allocated to cash, and the second will help offset the negative effects of cash drag and inflation forfeiture. We've provided some background on these subjects to serve as a reference point.

**Right-Sizing Cash Allocations |** Cash flow analysis measures the cash that comes into an entity (inflows) and leaves (outflows); we could also refer to these as revenues and expenses. Risk analysis considers the probability that unwelcomed events will come to pass and the cost associated with their mitigation. Affluent investors need to combine forward-looking cash flow and risk analyses to develop a reasonable estimate of their cash needs.

Philosophically, it's important to understand that cash allocations should be large enough to satisfy anticipated and potential expenses, but not much larger, given the minimal expected returns on cash.

**Putting Cash to Work |** Investors can improve on zero nominal returns (or negative real returns) for cash with a little bit of effort. In fact, many brokerage accounts automatically "*sweep*" un-invested cash into money market accounts; these are better than nothing, but not by much. The national rate on money markets is around 0.24%.

Consider how professional investors think about cash. International currency exchange rates, like any active market, are based on a lot of factors. One of the most significant factors in currency valuation is their "*carry*"—the level that short-term interest rates pay in each country's government-bond market. This is a roundabout way of pointing out that professional investors consider certain short-term government bonds as nearly equivalent to cash holdings, except for the fact that the bonds pay interest.

Short-term U.S. Treasuries are top-quality and highly liquid, meaning they could be expected to convert to cash without significantly impacting their price. They also yield more than money markets. For example, the 3-month Treasury bill currently yields over 2%. Tax-conscious investors could consider certain short-term municipal bond strategies, which are also typically high-quality and pay tax-exempt income.

Cash allocations are never going to be the star performers in any portfolio. But they can contribute enough to hold their own weight in offsetting inflation, so it's worth the effort to find a cash management approach that suits your needs. And limiting the size of your cash allocation to a reasonable level can help minimize the impact from cash drag.

---

For more information, please call **407.585.1160**