Don't trash cash as an investment choice

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COMMENTARY

"Cash is trash." It sounds catchy. Unfortunately, like a lot of market "truisms," this one is flawed.

The gist of the statement is that cash generally earns so little in short-term interest that it is a "trashy" investment — one not worthy of the term "investment."

For the purposes of this article, "cash" means funds you can immediately invest earning short-term interest in overnight money market funds. Therefore, "cash" is actually earning interest, not sitting idle earning nothing.

The first thing wrong with our "truism" is that it does not consider both risk and reward. All investments have risk of loss, even if that loss is the loss of purchasing power through inflation. There is no such thing as a risk-free investment, but cash is as close to risk-free as possible.

If an investor chooses to apply funds to an investment besides cash, consideration should be given to the potential additional reward and additional risk of loss of the new investment as compared to cash. Is the additional reward worth the additional risk? This standard should be used whenever changing from one investment to another. Sometimes it can improve your reward/risk ratio to move to less aggressive investments with lower upside potential, but much lower downside risk.

Second, our "truism," like most market truisms, does not consider market conditions in its assertion that "cash is trash." Market conditions cover a broad range, from raging bull market optimism to black bear market despair. The thinking investor knows that risk, reward and their ratios change as market conditions change. Market conditions do change, and sometimes they can change rapidly. Anyone who has experienced the pain of "riding out" a bear market plunge can tell you what a relief it is to ride out the next one in cash. Keeping profits is every bit as important as gaining them.

Here are some current market conditions:

■ Price-to-earnings ratios for all major indices are much closer to historic bull market tops than bear market bottoms.

■ The current fed funds rate is 4.75 percent. The recent dividend yield on the **Standard & Poor's 500** stock index is less than 2 percent.

■ The yield curve has been inverted. Continuing yield curve inversion has historically been able to predict upcoming recessions with about 80 percent accuracy.

■ Stock markets enter some form of bear market about six months prior to the onset of the recession.

Two things stand out if you agree with the above assessment of current market conditions:

■ Market conditions appear to be leaning more towards risk than reward.

■ Current overnight funds rates exceed the average dividend rate of the S&P 500, comprising the largest and most successful businesses in the world.

Why would an intelligent investor want to take the additional risk to buy stocks in the S&P 500 with historically high P/E ratios yielding less than half of overnight rates? Answer: He/she wouldn't. Prospective action: Sell stocks and buy short-term Treasuries or stay in overnight funds. If many rich, savvy investors do this, what are the likely market prospects?

Considering current market conditions, it's safe to say that for now, cash is definitely *not* trash. It's likely anyone making this assertion these days is either uninformed or trying to sell you something.

Sometimes, significant cash positions may actually provide the best overall reward/risk ratio for your investment portfolio. Don't let some phony market "truism" blind you into creating an unwanted loss in your net worth.

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Here's the latest article I had published in the KC Star. I thought you might want to see it! -Cal