2020 Financial Planning

What Role Should Cash Play in My Wealth Plan?

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Cash isn’t an afterthought, something that remains when all the other asset allocation decisions are made. Even experienced investors can wind up with too much or too little cash-- balance and diligence is key.

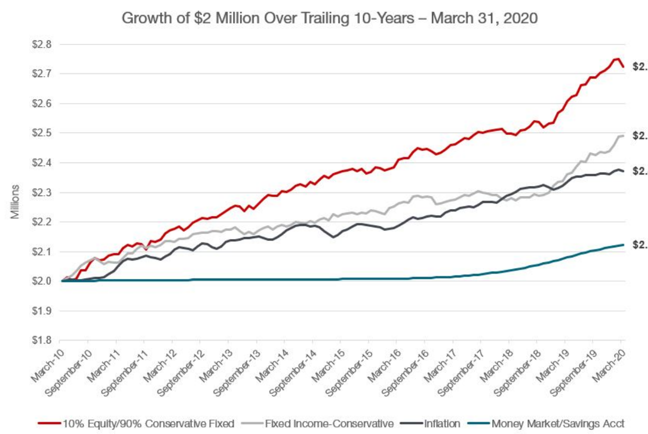
Investors often have a conflicted relationship with cash. In down markets, there is a temptation to flee to cash even though you may run the risk of losing out on attractive investment opportunities. In bull markets, the reverse is true: Cash may fall to negligible levels as investors seek to be fully invested. And there are times when an investor’s cash position is considered an afterthought.

Cash is an essential part of a comprehensive financial plan — it’s not an afterthought, something that remains when all the other asset allocation decisions are made.

The roles of cash in a financial plan

Cash performs essential functions in a well-designed portfolio: With a cash reserve in place, you can:

• **Deal with the unexpected.** Cash or cash equivalent investments, such as money market funds are highly liquid and can be easily accessed. Cash provides a cushion for financial reversals, such as unexpected expenses, a reduction in income, or loss of a job. If an emergency strikes and there’s no cash reserve in place, you may need to sell assets at an inopportune time or take on debt.



• **Take advantage of new opportunities.** One of the most significant benefits of holding cash is that it allows you to take advantage of attractive investment opportunities when they surface. Separate from the cash you keep in your emergency fund, an opportunity cash reserve gives you the flexibility to make new investments in assets at reasonable prices when the time is right — without having to sell or reduce an existing position.

• **Improve downside protection in challenging markets.** Defensive assets such as cash have low or negative correlations with equities, an especially attractive feature when equity markets decline. While all defensive assets have this characteristic, cash offers the additional quality of price stability: Even though other defensive asset classes may be highly liquid, they can still experience price volatility. Because of its stability, cash can serve as an anchor for your portfolio during challenging times: When markets are unsettled, and other investors are panicking, having a cash reserve can provide you with greater peace of mind.

The challenge of finding the optimal cash level

Cash plays an undeniably important part in your financial plan, but there are drawbacks to having too much cash in your portfolio. While it is the safest and most liquid asset you can hold, cash offers the lowest return of the major asset categories. And even though inflation is at historically low levels today, there is always the risk that rising price levels can erode cash positions over time.

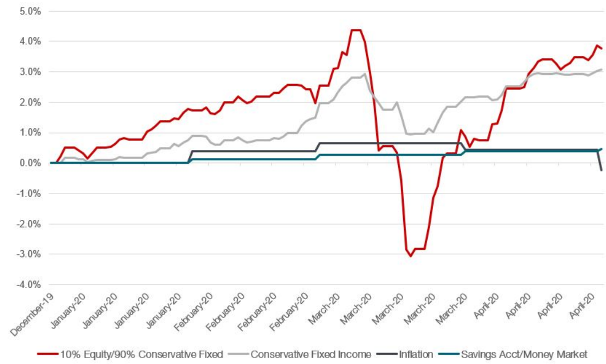
It's crucial, then, to find the best mix of cash and other assets in your portfolio, a task that can be more difficult to do than it seems. First of all, your needs and situation are unique to you — there is no simple algorithm that can give you the "correct" answer. Your circumstances evolve, and financial market conditions change, making it a necessity to regularly revisit your asset allocations.

Some investors choose a self-directed approach to investing and portfolio management. However, it doesn't take long for portfolios to deviate from intended asset allocations due to changing market conditions. This can make it challenging to keep cash at target levels as time passes-- a compounded problem if the investor has multiple investment accounts. Also, self-directed investors may develop portfolios that are "barbelled", with investments in short- and long-term assets. As a result, they forsake opportunities in intermediate-term investments and have a less-than-optimal portfolio from risk-return and liquidity perspectives.

Fear of loss can cause investors to defer decision-making and hold too much cash in their portfolios: They try to pick the right time to put cash to work and wait for a significant pullback. However, when prices do drop, they may still hesitate because they are worried that the market might fall even more.

As a result, even experienced investors can wind up with portfolios that have too much or too little cash, which can cost them in the long run.

2020 Year-to-Date Performance



Return Statistics – Trailing 20-Years

Investment	Return	Worst 12-Month Return	Max Drawdown
10% Equity / 90% Conservative Fixed	5.2%	-1.6%	-7.5%
Conservative Fixed Income	3.8%	-0.5%	-2.7%
Inflation	2.1%	-1.4%	-4.4%
Savings Account/Money Market	1.6%	0.0%	0.0%

Incorporating cash into your wealth plan

An experienced investment advisor can help you determine the right amount of cash to hold in your portfolio as part of your overall financial plan. An advisor works with you to create a customized, disciplined asset allocation plan to grow assets, optimize tax strategies, generate income as needed, and maintain your desired level of risk. The result is a diversified portfolio across a range of asset classes, including cash and other defensive assets.

With the advice and expertise that your advisor provides, you can avoid overreacting to short-term events and remain focused on your long-term plan. An advisor can integrate investment advice into your comprehensive wealth management strategy and schedule regular reviews to keep your portfolio aligned with your objectives, including your cash allocations.

For more information, please contact your Key Private Bank Advisor.

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