The power of cash in your portfolio

We tend to think of cash as a fundamental part of our finances. But it's also a fundamental part of an investing portfolio and overall financial plan. In this article, we're going to look at what cash means in investing, its role in your portfolio, and how it may be able to help your portfolio through various market conditions.

What is cash?

Cash is so much more than the dollar bills you withdraw from the ATM. It's also the money sitting in that bank account and the opportunity it represents. The same benefit cash presents in daily life—the ability to buy things—applies to your investment accounts.

In investing speak, we call this opportunity liquidity. Cash is an easily accessible asset that you can use to seize an opportunity, whether it's a down payment on a house or buying into a new fund. Like stocks and bonds, cash is a primary component of an investment portfolio.

What are cash equivalents?

Most people aren't sitting on piles of physical cash. When we talk about cash, we're including cash equivalents. Cash equivalents are products or investments that generate a greater return (or yield) than a basic savings account, while still offering liquidity. In other words, cash equivalents can be easily and quickly converted into actual cash if necessary.

Examples include certificates of deposit (CDs), Treasury bills, and corporate paper. We often use money market funds as a way to access multiple types of cash equivalents, so they are often thought of as a cash equivalent in their own right.

Some of these products are insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000. Others are qualified as investments, so they don't qualify. As with other types of investments, the level of security in the asset can impact the potential rate of return.

Tevis fund managers typically place cash allocations into Treasury bills or short-term money market funds.

The role cash plays in your financial plan

Cash equivalents play an important role in each client's portfolio and financial plan because they allow us to adapt quickly to market changes. Often, investors turn to cash when markets are volatile. This can present both risk and reward. On the one hand, a cash allocation can help protect you from market volatility (something our fund managers consider). On the other hand, cash allocations are subject to inflation risk.

Every so often, however, markets present an opportunity. When the Federal Reserve is raising interest rates, it can create a phenomenon called yield-curve inversion. When this happens, short-term loans (like the kind you see in cash equivalent products) pay a higher interest rate than long-term loans. That means lower-risk assets, like cash equivalents, may offer a higher yield than some longer-term investments, while still protecting investors from market volatility. In today's environment, clients have a rare opportunity to take advantage of short-term debts with high returns.

As an added bonus, when markets turn around as they inevitably do, a cash allocation creates the opportunity to buy back into other asset classes. At Tevis, we continue to monitor current market conditions to help spot opportunities for clients.