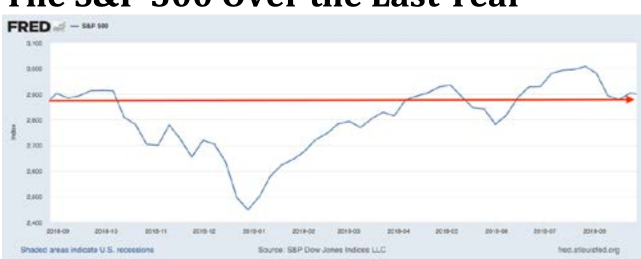
Mitch on the Markets

The Perils of Moving Investments to Cash

By Mitch Zacks
CEO & Senior Portfolio Manager

U.S. and global equity markets have been in a sustained volatile patch since early summer, and a look at the S&P 500 over the last year demonstrates how the ups and downs have netted flat returns. Whether you want to blame the trade war, slowing corporate earnings growth, weakening China and European economic fundamentals, the inverted yield curve, or some combination of them all, stocks have been fighting an uphill battle.

The S&P 500 Over the Last Year



Source: Federal Reserve Bank of St. Louis[1]

As uncertainty grows over how much longer the global economic expansion can last, central banks and governments have been posturing to respond with fresh economic stimulus, rate cuts, or both. But at the same time, investors have been increasingly pouring into safer assets like U.S. Treasuries. As you can see in the chart below, the 30-year U.S. Treasury (red line) and the 10-year U.S. Treasury (blue line) have been in a sustained decline as demand for safety continues to rise.

Source: Federal Reserve Bank of St. Louis[2]

Some investors may look at the broader picture and think, "Wouldn't now be a good time to go to cash?" If the future is this uncertain and all the signs are pointing towards a recession and weak stock performance in the short-to-medium term, why not just shift to cash and wait until the economic outlook improves?

But my message to clients is simple: *even in uncertain times, going to cash is not a good idea*. I believe that as a general rule, a high allocation to cash over the long-term raises the risk that you could fall short of achieving your financial goals. The two exceptions to this rule, in my view, are (1) if you have the cash earmarked for a short-term cash flow need, say in the next year or two; or, (2) if you have sufficient wealth that you don't need growth to meet your financial goals. Outside of these two exceptions, I think you should plan to stay invested.

To see why timing the markets and avoiding risk by going to cash can be harmful, just look at what happens if an investor misses big up days in the market. The hypothetical table below looks at the performance of $10,000 invested in the S&P 500 between January 4, 1988 and December 31, 2018. It's important to note that this $10,000 was exposed to two of the biggest bear markets in stock market history, the 2000 tech bubble crash and the 2008 global financial crisis.

	Fully Invested	**Missed 10 best days**	**Missed 20 best days**
Annualized Return	+10.05%	+7.61%	+5.96%
Total Cumulative Return	1846.86%	871.60%	502.18%
Ending Value	$194,686	$97,160	$60,218

	Missed 30 best days	**Missed 40 best days**	**Missed 50 best days**	**Missed 60 best days**
Annualized Return	+4.54%	+3.24%	+2.03%	+0.91%
Total Cumulative Return	296.39%	168.90%	86.56%	32.5%
Ending Value	$39,639	$26,889	$18,656	$13,250

Even missing the 10 best days over that period meant leaving half of your potential total return on the table.

But here's the real kicker: Six of the 10 "best days" in the market were within just weeks of the worst days in the market. In other words, some of the best days often happen as "v-shaped" bounces off the worst days. Going to cash on a big negative day means increasing the risk of missing a big positive day, which as you can see from the table above, can have a significant impact on total return over time.

Bottom Line for Investors

Uncertainty and volatility in the equity markets is likely to persist for the balance of the year and beyond. However, I firmly believe that running for cover by going to cash is the wrong response. In my view, doing so reduces your chances of reaching your long-term goals.

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About Mitch Zacks

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] S&P Dow Jones Indices LLC, S&P 500 [SP500], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SP500, September 4, 2019.

[2] Board of Governors of the Federal Reserve System (US), 10-Year Treasury Constant Maturity Rate [DGS10], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DGS10, September 3, 2019.

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