Cash Will Keep Us Calm

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With interest rates dropping to historical lows so has the interest of investors in holding cash. When cash is paying next to nothing in earnings there may seem to be no grounds to hold the cold, hard stuff but there are still several good reasons to do so. These reasons need to be revisited during this period of historically low rates, if for no better rationale than as a reminder to investors that low yields have not affected the arguments to hold cash in some situations.

We had a client buy a house in January, closing in April. We insisted that he sell out the equities as soon as the home purchase was made. There was some questioning of this by the client but he agreed and was, I hope, grateful for this advice. Imagine buying a new home and 40% of your money to pay it off has disappeared. That would certainly cause a change in a person's lifestyle, especially if the buyer was semi retired as was the case in this scenario.

It is a basic tenet of money management that a retired person should have three years worth of cash available in their portfolios to weather the ups and downs of equity markets. This is based on the same premise of the homebuyer above. You want to be the one deciding when to sell, not having it forced upon you by market forces. The cash needed to live on may not earn much of a positive return but it doesn't drop in value.

The rainy day fund that most financial planners would include in a household budget provides the cushion for life's unexpected misadventures. You could lose your job, the car breaks down, or the roof starts leaking. Planners often suggest three months of living expenses set aside in cash, to be prepared for these curve balls and bumps in the road.

Home Lines Of Credit (LOC) have become more readily available and oftentimes unused LOCs are substituted for cash. It is important to note though that one must remember to apply for an LOC before you need the money. If you wait until you are under financial duress, you may find that your lending institution isn't as attentive as you may wish. The ideal strategy is to have the three months worth of cash itself available in a bank account.

The cash you have set aside needs to be invested. If you are comfortable with your financial institution's credit worthiness, staying in cash, as long as you are being paid some interest, may be fine. However, in Canada deposits are generally only guaranteed up to $100,000 dollars. So, if there is any doubt, Government of Canada T-Bills or other secure money market instruments should be considered.

There is no doubt that there are risks to holding too much cash. For example, your purchasing power is reduced since often the interest rate earned is less than inflation, especially if tax also has to be paid.

Some cash though is a necessity. Depending on your age, savings rate and retirement status everyone should be holding some. When the emergency happens or the markets fall it will be an emotional comfort to know that you are able to ride out the rough patch without significantly curtailing your lifestyle.

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