U.S. News & World Report

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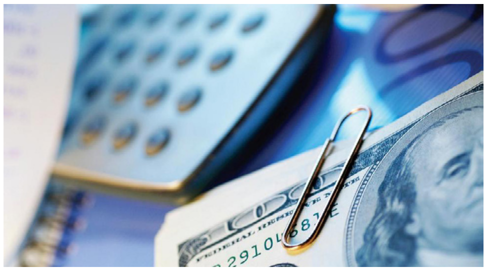
USE CASH TO YOUR ADVANTAGE AS RATES RISE

Laddered investments and other strategies let you pounce on higher-yielding opportunities as they arise.



By: Rebecca Lake - September 1, 2017

As safe investments go, cash is hard to beat. The downside is compared with stocks or mutual funds average returns are meager, but that could change as interest rates rise.

"Having money on the sidelines in cash may not seem like the best approach when interest rates are near record lows," says Erin Scannell, a financial advisor with Ameriprise in Mercer Island, Washington, but investing in cash has advantages. It allows investors to bargain hunt for stocks during a correction or bear market and "find high-quality investments at potentially far better prices than the latter stages of a bull market."

Speculation about the possibility of a market correction happening has some investors giving more thought to their cash holdings. According to a July fund manager survey from Bank of America Merrill Lynch, investors are keeping 4.9 percent of their assets in cash, higher than the 10-year average of 4.5 percent.

A quarter of those investors said they were overweighting cash in case a bear market arrived, while 20 percent said they preferred cash to other low-yielding assets. With the Federal Reserve raising the federal funds rate twice so far in 2017 and additional increases expected in 2018, cash may become even more attractive for certain investors.

Tad Hill, founder and president of Freedom Financial Group in Birmingham, Alabama, says holding cash makes sense if you have a lower risk tolerance. When you invest cash in vehicles that offer a guaranteed rate of return, "you can benefit from the rate increase and save your money from the risk of the stock market."

But how much of your portfolio should you dedicate to cash, and where should you invest it to take advantage of rising rates?

Find the right balance. Too much cash in a portfolio can be a liability, even if cash investments are outperforming fixed-income investments, such as bonds. Hank Smith, co-chief investment officer at Haverford Trust in Radnor, Pennsylvania, says timing can influence how much of your assets should be allocated to cash.

When rates rise, bond prices generally fall while cash investments offer more consistency. With stocks, however, the relationship is less cut and dried, Smith says. When rates first begin rising, stocks may outperform cash if the economy is going strong. If economic conditions change, however, cash investments may gain ground, particularly if stock prices begin falling ahead of a recession. Smith says that when the economy is booming, "having too much cash could be a drag on performance."

What you need your money to do for you is also relevant. Mike Windle, a retirement planning specialist at C. Curtis Financial in Plymouth, Michigan, advises looking at your income needs, risk tolerance, investment goals and the rate of return you need to earn to reach your objectives.

"If you only need a 2 percent average rate of return to meet your goals, you could put more money into safer investments," Windle says. On the other hand, if you need something closer to 8 percent to hit your targets, you need more money in the market and less in cash.

Consider your choices. Options abound for investing cash, including savings accounts, money market accounts and certificates of deposit, with some better suited than others when rates rise.

While the products your bank offers are a good starting point, Hill encourages investors to look at other ways to invest cash. He says a fixed annuity may offer better rates than a CD long term, and unlike stocks or bonds, the annuity doesn't "go down with the market." He does caution investors to be aware of any surrender penalties for withdrawing money early. If liquidity is a priority, a savings account may be better.

Treasury bills are another alternative to CDs. Albert Brenner, director of asset allocation strategy at People's United Wealth Management in Bridgeport, Connecticut, says that bank rates generally lag those of money markets. Investors who are considering these options should compare Treasury yields to the rates traditional brick-and-mortar banks pay.

Except for a few caveats, short-term bonds, bond funds or bond exchange-traded funds shouldn't be counted out completely when rates rise. The holdings of bond funds or ETFs should align with the fund's stated objective, Smith says. A short-term bond fund designed as a cash substitute "should not have intermediate or long-term bonds as investments, nor should it have leverage unless it's clearly stated" that it's part of the fund's strategy.

Brenner cautions investors against investing cash in anything they don't fully understand. Otherwise, he says, they might mistake funds that offer liquidity for cash or cash-equivalent funds. A friend of Brenner's once invested in a high-rate fund that allowed him to add or withdraw money at any time, which turned out to be a long-term bond fund. As rates rose, the entire investment was subject to market value losses. So if something seems too good to be true, it probably is.

Stay nimble. As rates change, investors should be prepared to pivot if needed. Scannell says investors should avoid locking cash into long-term investments if they think rates will continue to climb. Sticking with money market accounts or short-term CDs versus long-term bonds, for instance, frees investors to take advantage of higher rates in the future. Flexibility and liquidity are vital, giving investors the ability to move into higher-yielding vehicles when the chance arises.

Dollar-cost averaging is a good strategy if the market is still growing while rates increase. Windle says this approach allows you to slowly capture market gains while still maintaining a base of safe cash investments. He also advises laddering cash investments in CDs or bonds.

By laddering investments with different terms, you can renew them if rates climb or withdraw the money at maturity and reinvest it elsewhere. Just remember what your overall asset allocation mix is as you shuffle cash around. Above all, don't let panic guide your investment choices.

"If a market correction makes you feel like you need to move your stocks to cash, you're not investing properly," Hill says. "The stock market is a long-term investment, and you should be prepared to live without that money for years."

Mike Windle is a retirement planning specialist for C. Curtis Financial Group. His focus is on ensuring his clients have all the critical facts necessary to make a sound financial decision. Mike holds multiple securities and insurance licenses that allow him to provide the best solutions for his clients.

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