Investment Insight
Addressing Cash on the Sidelines with Clients

Investors are reluctant to invest after tough markets. This is human nature — and seemingly — a fact of life.

The past few years fit the bill for tough market: 2022 was the worst year for stocks since 2008; bonds are in their worst three-year drawdown ever; and diversification — namely small caps and non-U.S. stocks — haven’t added the value many hoped.

The fallout? Investors are favoring cash.

Rate hikes over the past 18 months have given cash an income stream investors can feel good about. Many money markets funds — generally viewed as cash proxies — now yield more than 5%.

After a decade of “savers are being punished!” the page has turned to a new chapter.

BlackRock’s CFO was recently asked about the biggest trends shaping their business. It didn’t take much soul-searching to form a response, quickly mentioning:

“Rotations out of equities and into cash has been the main theme.”

Dollar flows match that statement: This year will likely be the biggest year ever for cash. Through September, nearly $940 billion has flowed into money market funds.
By year-end, that number will likely surpass $1 trillion.

Bloomberg recently reported that the top 12 mutual funds by flows this year are all money market funds. The degree to which investors have hunkered down in cash is represented by nearly $7 trillion in money market fund assets across the industry.

Every financial advisor is grappling with this topic. The conversations vary, but the central element is that investors are choosing to hold more cash.

So the question becomes: What are good ways to get clients back into the market?

The data strongly implies that cash should not be used as a substitute for stocks. But clients aren’t always moved by data—there’s an emotional push and pull that can be hard to overcome.

While generalizing, clients with large cash positions tend to fall into two categories:

1) Clients who have increased their cash position permanently.
2) Clients who moved to cash based on recent experience (read: tough market).

For many investors in category one, there’s probably not much to be done. Maybe there’s a perfectly good reason for this. One example might be a client who has a financial plan that is fully funded.

In such a case, the client has no appetite for risk. The pain of investment losses is much greater than the reward that would come from any investment gains.

But for category two, the client may be waiting for the proverbial “things to settle down” before they re-enter the market.
In that case, there’s a few simple steps that might help frame a worthwhile conversation.

**Step 1: Empathize**

Empathy is one of the strongest traits an advisor can possess.

It usually shows itself in the form of active listening— which requires listening attentively, acknowledging concerns, reflecting on what’s being said, and trying to find a reasonable solution for situations that are ripe with emotions.

Put simply, the goal is to make it clear a client is being heard and their concerns are acknowledged.

Something as easy as, "I see where you’re coming from. Cash is more attractive than it’s been in a decade, and it’s perfectly reasonable to believe markets could deliver more turbulence again soon. Nobody has a crystal ball!"

Empathy carries a lot of freight and allows you to move on to step two.

**Step 2: Educate**

The funny detail about lots of investor dollars moving to cash? It tends to coincide with market troughs, as you can see below.

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**Exhibit 2**

![Money Market Total Assets ($ trillions)](image)

- **Cash Peak: Jan. 2009**
- **S&P 500 Low: March 2009**
- **Cash Peak: May 2020**
- **S&P 500 Low: March 2020**
- **Cash Peak: Sept. 2023**


In all the recent money market peaks, the equity market rallied shortly after. Now of course, this doesn’t mean correlation equals causation. And past performance doesn’t mean it will happen again this time!
But you can certainly make the case that high cash levels have represented an opportunity to buy when others are fearful.

Another consideration would be inflation. Money markets have gone from earning nothing to 5% in a short amount of time. Undeniably, this has been a welcome change for many investors!

But inflation remains elevated at more than 3% and the spread between cash rates and inflation is likely not wide enough to warrant replacing substantial portions of a diversified portfolio with it.

Another caveat? Rates can go down! And looking at implied rate expectations, it looks like the path of least resistance for rates might actually be lower starting next year.

Exhibit 3

Market Expectations for Federal Funds Rate

Source: Chicago Mercantile Exchange. Data via fed funds futures market as of 11/15/23.

There are certainly caveats to make. May clients have short-term cash needs — saving for a house, tuition payments, planning a wedding, etc. — and that money should not be in the market. This is a welcome environment for those types of situations. But for those with longer time horizons, despite higher rates, cash should not be thought of as an equity substitute.

But for all dollars being allocated over a multi-year timeframe, there’s still likely only one place to invest to consistently outpace inflation: the stock market.

Step 3: Enact a Plan
Dollar-cost averaging (DCA) tends to be the best way to manage client emotions around putting cash to work.
The data strongly indicates that the best time to invest money is whenever you have it. But as any advisor knows well, people aren’t robots—and even if the data is overwhelming—it won’t always resonate.

As has been said, “DCA is not a return tool, it’s a human emotion tool.”

If you have a nervous client who invests a large sum, and it syncs up with a market correction, they’re not going to be happy. And an unhappy client quickly leads to an unhappy advisor!

That’s why a DCA plan can be one effective way to push clients to put money to work.

Another worthwhile exercise might be to ask a client how much of their assets they need in cash to feel secure.

Is it all of it?

Is it some of it?

Is it a few years’ worth of spending?

Basically, you’re trying to tease out a number that makes clients feel comfortable—even if it’s an oddly specific number that resembles no bearing to anything.

If you can find whatever that number is, then you can move to enact a plan. Simply knowing this number allows an advisor to ask, “Are we OK to start putting cash above that number back into the market?”

Some people simply need a conversation to harden their own thinking and determine the right security blanket.

**The Numbers Only a Fraction of Good Financial Advice**

The argument can be made that managing clients’ emotions, expectations, and psychology is more important than managing clients’ money.

Amidst a unique backdrop, many investors are reluctant to invest. Rather, they’re finding it more comfortable to hold higher yielding cash.

In some client cases, holding excess cash may be warranted. But in many others, it likely isn’t. The burden falls on advisors—who face the challenge of getting clients to re-engage with the market and help them understand there are significant trade-offs.

In short, data and numbers are sometimes only a small part of the investment journey.
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