TritonPacific
Securities, LLC

THE CONSEQUENCES OF CASH

Investors may often hear that "cash is king," but holding on to too much cash and staying out of both private and public investments may have serious repercussions on an investor's portfolio.

Cash has its place in any financial plan. It may offer valuable liquidity, which is important for emergency funds or the purchase of everyday goods.

Too often, though, the decision to hold on to cash is an emotional one, not tactical or strategic. During times of market volatility, the allure of cash is often enticing, as investors may fear potential losses and feel that cash may give them more control. For example, at the beginning of the COVID-19 pandemic in March 2020, investors pulled $71 billion from U.S. equities – and missed out on a 39.3% rebound as of June 30, 2020, as measured by the S&P 500.[1] Similarly, private equity fundraising fell from $360.8 billion in 2019 to $259.5 billion in 2020, among concerns caused by the global pandemic. It quickly recovered, however, rising to a record-setting $362.7 billion in 2021 and a nearly identical $361.6 billion in 2022.[2]

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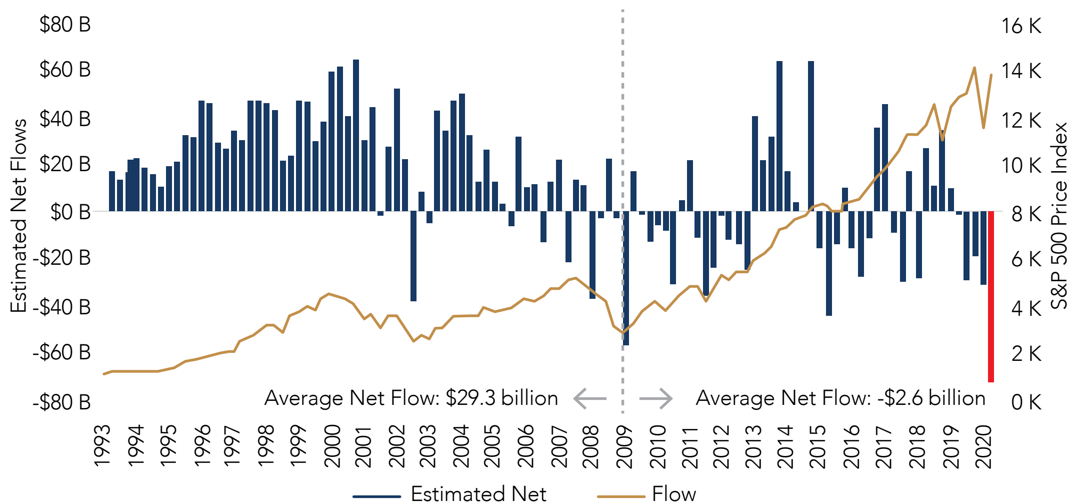
U.S. Equity Net Flows[3]
(Mutual Funds & ETFs)



1. Gavan, Mike. "The Risks of Fleeing to Cash in Times of Crisis." August 6, 2020. https://russellinvestments.com/us/blog/risks-fleeing-cash-crisis. The S&P 500 is an unmanaged group of securities considered representative of the U.S. stock market in general. Investors cannot invest directly in an index. Past performance is not a guarantee of future results.
2. U.S. PE Breakdown: Q1 2023. PitchBook. 2023.
3. Morningstar Direct. Cumulative Flows: Bond Flows: Morningstar Broad Category, Bonds: Taxable Bonds, U.S. Equities, Cash: Money Market – Taxable.

During times of crisis, investors often start to think of challenging markets of the past, such as the Great Financial Crisis. Add these memories to an often-frightening deluge of news headlines and many investors may quickly forget about their long-term financial goals. Currently, 62% of Americans claim that they would rather have cash on hand than weather the potential swings of the market.[4]

While holding cash may provide a sense of security, it may also come with significant consequences for investors, including missed opportunities, loss due to inflation and even psychological effects. In this article, we will explore the ramifications of staying in cash and shed light on the potential challenges and pitfalls that investors may encounter along the way.

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CASHING OUT MAY MEAN MISSING OUT

No matter how "dry powder" strategies may be described, when investors hold on to cash to invest in the market later, they are essentially utilizing a market timing strategy. Market timing is the act of moving investments in and out of the financial market, and while it may be a key component of actively managed investment strategies, it may also be incredibly difficult, especially for the retail investor. That is because the investor must be right twice – they must correctly identify a high point at which to sell and a subsequent low point at which to buy back in. If they are wrong at one or both of these junctures, their portfolio would likely have done better if they had remained fully invested.

Being out of the market for only a short time may have dire results. For example, an investor who invested $100,000 and stayed invested over ten years, ending June 30, 2020, would have grown their investment to more than $300,000. If that investor missed just the ten best days during that time frame, the portfolio would end up 44% lower.[5] The loss only grows with the more days missed.

THE CHALLENGE OF MARKET TIMING[6]

Missing the best days – 10 years ending June 30, 2020

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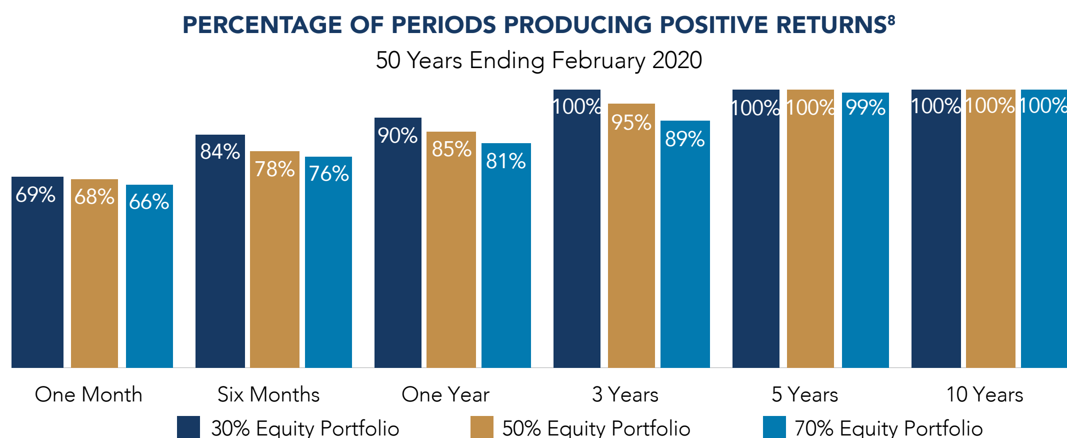
4. "Most Americans Say They Can't Count on Social Security for Retirement Income." April 10, 2023. https://www.allianzlife.com/About/Newsroom/2023-Press-Releases/Most-Americans-Say-They-Cannot-Count-on-Social-Security-for-Retirement-Income
5. Gavan, Mike. "The Risks of Fleeing to Cash in Times of Crisis." August 6, 2020. https://russellinvestments.com/us/blog/risks-fleeing-cash-crisis
6. Russell Investments, Confluence. In USD. Returns based on S&P 500 Index, for the 10-year period ending June 30, 2020. For illustrative purposes only. Index returns represent past performance. Past returns are not a guarantee of future performance and are not indicative of any specific investment. Indexes are unmanaged and cannot be invested in directly.

A TALE OF FOUR INVESTORS

It is true that capital markets have produced negative results at times, especially along shorter timelines. Over the last approximately 50 years, diversified portfolios have produced negative returns about one out of every three months. As this timeline is extended, however, the negative numbers quickly begin to fall, until diversified portfolios are generating positive returns 100% of the time.[7]

PERCENTAGE OF PERIODS PRODUCING POSITIVE RETURNS[8]

50 Years Ending February 2020



While capital markets have produced negative results at times, over an extended timeline, diversified portfolios have been shown to generate positive returns 100% of the time.[7]

In a long-term scenario, let's take a look at four hypothetical investors who employed different strategies involving market timing. Let's assume that each investor started with $100,000 in a balanced portfolio between January 1, 2006 and June 30, 2020.

First is Sally, our steadfast investor. She consistently invested $8,000 per quarter until June 2020. Her total net investment during the time period was $556,000, and her portfolio grew to over $1.1 million. Despite experiencing both the Global Financial Crisis (GFC) and the COVID-19 pandemic, Sally's portfolio achieved a cumulative return of 209%.

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Next is Greg. Greg followed Sally's investment strategy but moved to cash at the end of December 2008, when his portfolio was valued at $166,000. By exiting before the bottom of the GFC on March 9, 2009, he avoided further losses. Greg re-entered the market on January 1, 2010, seven months into the GFC rebound, and resumed his $8,000 dollar cost averaging per quarter. Greg learns from exiting during the GFC and stays invested during COVID-19. By June 2020, his portfolio was worth around $980,000, approximately $167,000 less than Sally's.

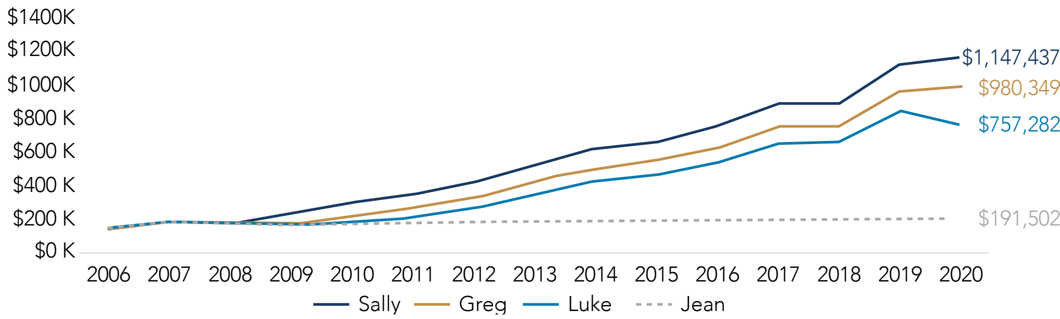
Following Greg is Luke. Luke's strategy was similar to Greg's, but Luke tried to time the market. He re-entered the market in early 2011, a year later than Greg. Then, over nine years later, Luke moved back to cash at the end of March 2020, right after the COVID-19 market bottom on March 23. At the end of May 2020, Luke is afraid of missing out and reenters the market, only to experience an 831-point drop from the S&P 500 shortly after re-entering. By the end of June 2020, Luke's account was worth $757,000, over $390,000 less than Sally's and $223,000 less than Greg's.

Finally, Jean used a similar investment scheme as Greg but was never comfortable returning to her previous investment strategy after leaving the market in 2009. She remained in cash and her portfolio gained 2% and was worth $191,000, approximately $3,500 more than the total amount invested. This scenario could be considered the worst case.

7. Smith, Mike. "Thinking About Market Timing?" March 16, 2020. https://russellinvestments.com/us/blog/thinking-about-market-timing-2
8. Hypothetical analysis provided for illustrative purposes only. Diversified portfolios include three index portfolios comprised of S&P 500 Index (S&P500), MSCI EAFE Index (EAFE), and Bloomberg U.S. Aggregate Bond Index (AGG); 30% Equity: 20% S&P500/10% EAFE/70% AGG, 50% Equity: 34% S&P500/16% EAFE/50% AGG, 70% Equity: 47% S&P500/23% EAFE/30% AGG. The S&P 500 is an unmanaged group of securities considered representative of the U.S. stock market in general. The MSCI EAFE Index is an equity index which captures large and mid-cap representation across 21 Developed Markets countries around the world, excluding the US and Canada. The Bloomberg US Aggregate Bond Index is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. Investors cannot invest directly in an index. Past performance is not a guarantee of future results.

WANT TO TIME THE MARKET?[9]

Historically, it's better to stick with your long-term plan.



Hypothetical Investor	Scenario	Total Net Additions	Ending Portfolio	Cumulative Return	Net Gain	Net Benefit Going to Cash
Sally	Invested from January 2006 to June 2020	$556k	1.1m	209%	$591k	-
Greg	Invested from January 2006 to December 2008, **went to cash**, reinvested January 2010 to June 2020	$524k	$980k	171%	$456k	-35%
Luke	Invested from January 2006 to December 2008, **went to cash**, reinvested January 2011 to March 2020, **went to cash**, reinvested April 2020-June 2020	$484k	$757k	107%	$273k	-102%
Jean	Invested from January 2006 - December 2008, **went to cash and NEVER REINVESTED**	$188k	$192k	2%	$3.5k	-207%

INFLATION CREATES LOSS

Another consequence of remaining in cash is the erosion of purchasing power due to inflation. Inflation is the gradual increase in the prices of goods and services over time, which reduces the value of money. The current inflation rate, as of May 2023, is 4.05% and although the inflation rate has been dropping, it is still above the long-term average of 3.28%.[10]

While cash may seem safe, its real value diminishes as the cost-of-living rises, regardless of the actual inflation rate. A higher rate, such as often occurs during volatile markets, only means this value is diminished faster. By not investing and growing their wealth to outpace inflation, retail investors risk losing their purchasing power and may struggle to meet their financial goals in the long run.

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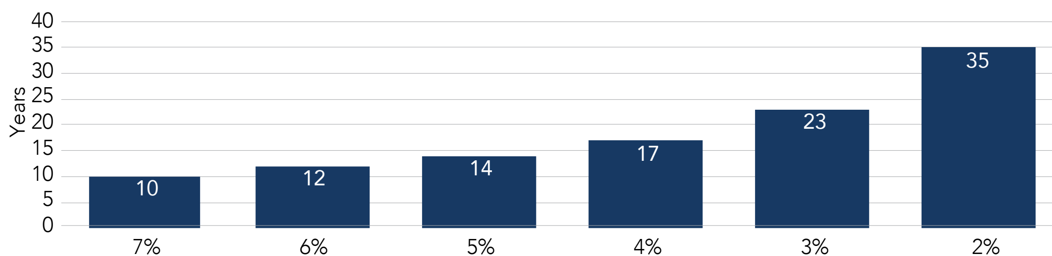
HOW LONG DOES IT TAKE INFLATION TO CUT PURCHASING POWER IN HALF?[11]



9. Morningstar Rebalance monthly. Net benefit by going to cash: Cumulative return of Greg, Luke, or Jean minus cumulative return of Sally. Balanced Portfolio: 60% S&P 500 Index, 40% Bloomberg U.S. Aggregate Bond Index. Cash:1.25%. For illustrative purposes only.
10. "U.S. Inflation Rate." May 2023. https://ycharts.com/indicators/us_inflation_rate
11. Kellar, Will. "The Risk of Holding Cash." March 30, 2022. https://www.humaninvesting.com/450-journal/the-risk-of-holding-cash

ADDITIONAL PSYCHOLOGICAL CONSEQUENCES

As mentioned earlier, the decision to stay in cash during volatile markets is often driven by emotions, such as greed or fear. Cash may feel like a safe haven and investors may temporarily forget about their long-term goals. An attachment to cash may have many financial consequences, which may contribute to extra stress and regret. Timing the market perfectly is nearly impossible, and investors who wait for the "perfect" time to invest may spend a lot of time and effort trying to find the right moment, only to realize that they have spent too long on the sidelines and missed out on potential gains.

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IF CASH ISN'T KING, WHAT ARE OTHER OPTIONS?

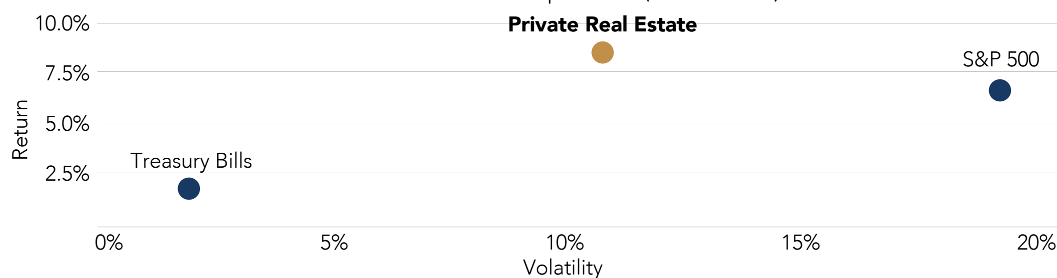
There are many assets that have historically outperformed cash. From 1973 through 2022, cash had an average historical return of 3.32%, while bonds returned 6.59% and U.S. equities returned 11.73% over the same time period.[12] Alternative investments, however, have often outperformed even U.S. equities.

From 1981 to 2021, private equity funds delivered an excess annual return of 4.3% relative to public equities. These funds generated even greater returns during periods of high inflation, with an excess annual return of 6%.[13] This may be because private equity managers have more control over the performance of their portfolio companies during stressful times.

Another historically outperforming asset class is private real estate. In the 20-year period from 1999 to 2019, private real estate generated higher annual returns than stocks with much less volatility.

PRIVATE REAL ESTATE [14]

Investment Risk-Return Spectrum (1999 – 2019)



12. Damodaran, Aswath. "Historical Returns of Stocks, Bonds and Bills: 1928 – 2022." January 2023. https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html. Arithmetic average return is a simple average of the annual returns over the specified period. U.S. Equities based upon the S&P 500. The S&P 500 is an unmanaged group of securities considered representative of the U.S. stock market in general. Bonds based on 10-year Treasuries. The 10-year Treasury note is a debt obligation issued by the United States government with a maturity of 10 years upon initial issuance. A 10-year Treasury note pays interest at a fixed rate once every six months and pays the face value to the holder at maturity. Cash based upon 3-month Treasury Bill (T-Bill). Treasury bills are a short-term U.S. government debt obligation backed by the Treasury Department with a maturity of one year or less. Treasury bill rates depend on interest rate expectations. Investors cannot invest directly in an index. Past performance is not indicative of future results.
13. Zhang, Hannah. "PE Has Outperformed Stocks for Decades – And Especially During High Inflation." https://www.institutionalinvestor.com/article/b8xnt5hvscvnyt/PE-Has-Outperformed-Stocks-for-Decades-And-Especially-During-High-Inflation. Private equity based upon the Burgiss U.S. Buyout Universe. Burgiss Private Capital Indexes are calculated using the Burgiss Manager Universe (BMU), a dataset for private capital funds, funds of funds and their holdings, available globally. The BMU covers more than 230,000 underlying holdings with a current valuation in excess of $5 trillion. The BMU is completely impartial, as it is sourced solely from hundreds of limited partners around the world who rely on Burgiss' data and analytics services. No data is sourced via voluntary manager data submissions, web scraping, or Freedom of Information Act requests. Only the data that passes Burgiss' intensive data scrubbing algorithms is incorporated into the BMU, ensuring the highest quality subset of data available. All classifications are assigned based on the Burgiss Private Capital Classification System (PCCS), resulting in greater transparency, standardization and precision. Since fund cash flows are actual cash flows from limited partners, the BMU represents the actual investment experience from the perspective of limited partners. For example, adjustments are not made for the subscription line of credit (SLOC). The BMU is unfrozen and reconstructed on a quarterly basis due to the unique nature of private capital data and the associated reporting challenges. Specifically, this process is designed to maximize the representative aspect of the BMU by reflecting all data available at the time of each update. This is a necessary component of private capital benchmarking and ensures that the data remains research quality over time. The BMU includes only private equity-style funds that are closed-end with manager discretion over cash flows; this means that any hedge funds, open-end funds, and other related vehicles such as directs and co-investments are excluded. Public equity based upon the S&P 500. The S&P 500 is an unmanaged group of securities considered representative of the U.S. stock market in general.
14. NCREIF. Private Real Estate reflects the NCREIF Open-End Diversified Core (NFI-ODCE) Index. The NFI-ODCE index is an index of investment returns reporting on both a historical and current basis the results of 38 open-end commingled funds pursuing a core investment strategy, some of which have performance histories dating back to the 1970s. It is capitalization-weighted and is reported gross of fees. Measurement is time-weighted. NCREIF calculates the overall aggregated Index return. Open-end funds are generally defined as infinite-life vehicles consisting of multiple investors who have the ability to enter or exit the fund on a periodic basis, subject to contribution and/or redemption requests, thereby providing a degree of potential investment liquidity. The term Diversified Core Equity style typically reflects lower-risk investment strategies utilizing low leverage and generally represented by equity ownership positions in stable U.S. operating properties diversified across regions and property types. Inclusion in the NFI-ODCE is based upon certain pre-defined index policy inclusion characteristics and to be included any fund must comply with the NCREIF Precision Real Estate Associaton (PREA) Reporting Standards; including annual audits, annual external appraisals, quarterly valuations and time-weighted returns. Further, a fund must submit information in accordance with the NCREIF Fund Data Collection and Reporting Manual (timely, accurate and industry compliant data is required). The NFI-ODCE returns reflect leverage and the impact of cash holdings and joint ventures (i.e., returns reflect each contributing fund's actual asset ownership positions and financing strategy). The use of leverage varies among the funds included in the NFI-ODCE. The NFI-ODCE is unmanaged and uninvestable. Past performance is no indication of future results. All investments have the risk of loss. The S&P 500 Index is a market-capitalization-weighted index of 500 leading publicly traded companies in the U.S. Treasury bills are a short-term U.S. government debt obligation backed by the Treasury Department with a maturity of one year or less. Treasury bill rates depend on interest rate expectations. Investors cannot invest directly in an index. Past performance is not indicative of future results.

While cash may seem like a safe and secure option, the consequences of staying in cash may be detrimental to the average retail investor. By choosing not to invest, individuals miss out on potential gains, suffer from the erosion of purchasing power due to inflation and often regret missing opportunities in the market.

THERE ARE ALWAYS REASONS NOT TO INVEST [15]

But investment portfolios should be built to last.

Year	Event	Cumulative Total Return
1999	Y2K	467.1%
2000	Tech wreck; bubble bursts	368.5%
2001	September 11	415.4%
2002	Dot-com bubble: market down -49%	484.9%
2003	War on Terror - U.S. invades Iraq	650.9%
2004	Boxing Day Tsunami kills 225,0000+ in southeast Asia	483.5%
2005	Hurricane Katrina	426.2%
2006	Not a bad year, but Pluto demoted from planet status	401.6%
2007	Sub-prime blows up	333.2%
2008	Global Financial Crisis; bank failures	310.6%
2009	GFC: market down -56%; depths of despair	551.8%
2010	Flash crash; BP oil spill; QE1 ends	415.4%
2011	S&P downgrades U.S. debt; 50% write-down of Greek debt	347.9%
2012	2nd Greek bailout; existential threat to Euro	338.6%
2013	Taper Tantrum	278.1%
2014	Ebola epidemic; Russia annexes Crimea	185.6%
2015	Global deflation scare; China FX devaluation	151.2%
2016	Brexit vote; U.S. election	147.8%
2017	Fed rate hikes; North Korea tensions	121.3%
2018	Trade war; February inflation scare	81.7%
2019	Trade war, impeachment inquiry, global grown slowdown	90.0%
2020	COVID-19 pandemic, U.S. Presidential Election	44.5%
2021	**Omicron variant, China regulatory crackdown, whats next?**	**22.0%**

"It is crucial for investors to strike a balance between liquidity and long-term growth," said Brian Buehler, managing partner, Triton Pacific Capital Partners. "Adding such alternative investments as private equity and private real estate may provide important diversification benefits, while working with a professional may help investors navigate the complex world of investing." Each investor must decide their timeline and risk tolerance, while keeping their long-range goals in mind. Only by embracing prudent risk and embracing the potential rewards of investing may retail investors continue to strive to achieve their financial aspirations.

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- Brian Buehler, managing partner, Triton Pacific Capital Partners.

15. J.P. Morgan Private Bank. FactSet. Cumulative total returns for S&P 500 are calculated from December 31 of the year prior to January 31, 2022.

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