Why Sitting in Money Markets May Prove Costly

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This week's article discusses what to do with cash balances that have become unwieldy, something we've started to notice a lot more frequently with investors. Frankly, the significant increase in money on the sidelines due to attractive risk-adjusted returns from cash equivalents has been a pain point for many financial planners, like myself. While money market vehicles are paying around 5% in "risk-free" income, many investors have started relying on them as a primary source of retirement cash flow and are now a substantial portion of their investment mix. If this 5% yield were expected to remain indefinitely, I would support this approach for most of my clients. However, this strikes as us highly improbable, and rates recently have already started moving lower. Investors who have been far too complacent may find themselves heavy on cash but light on places to put it.

It's not only DIY investors who find themselves facing this issue. Some investors like the idea of keeping large amounts of "dry powder" planning to buy into market weakness. Then there's those clients who we have on-boarded but were reluctant to "jump" straight into their maximum equity allocation given that stocks at or near all-time highs. Regardless, of the motive for parking capital in money markets, let's understand some of the risks and then some proposed solutions for remedying the situation.

First, excess cash can become a drag on long-term returns, if the market continues its momentous rise. This means there could be an opportunity cost if stocks, which have historically vastly outperformed money markets, continue to soar to higher highs. Second, investors become complacent, and mistakenly assume that money market rates will stay here forever, thereby not implementing more prudent investment strategies that take this into account. There are plenty of investments out there that offer equivalent returns as money markets, but with the promise of doing so longer into the future. Lastly, investors assume they'll be able to play age old game of musical chairs, suddenly altering their investments just before the music stops. Trying to perfectly time the markets can be a dangerous and costly endeavor. Instead, Evergreen's investment team prefers to follow the motto of "Up a little, sell a little. Up a lot, sell a lot. Down a little, buy a little. Down a lot, buy a lot." This describes the way that we fade in and out of areas of the market, rather than making 'all or nothing' moves.

Reasons vary as to why investors may have too much capital in money markets, but the reality is that we are potentially at the final exit before the toll. Below I propose three alternatives for you to consider before money market securities become deadweight in your portfolio. For current clients, any of these ideas can be discussed and implemented with your Wealth Consultant in a way that is customized to your financial plan and circumstances.

1. **Extend Duration and Move to Fixed-Rate Debt:** If you enjoy the liquidity and conservative risk profile of cash alternatives, this is a natural next step. While a money market is required to have an average maturity of 60 days or less, moving out further into intermediate term debt (bonds that won't mature for several years) can lock in similar yields for a longer period. Switching to a fixed interest rate (as opposed to a money market's floating rate) also allows for appreciation potential when rates begin to fall. Evergreen actively manages income, and the characteristics of our income models change frequently to adapt to the environment and our economic outlook.

2. **Dollar-Cost Averaging and Staying Alert:** Perhaps you see the merit in extending duration but don't want to be invested conservatively long-term. We encourage a combination of methodically adding risk over time while establishing goals for entry points where you would like to get more aggressive. For example, someone with $1,000,000 in cash equivalents could work with their advisor to invest $50,000 into stocks each month and agree to invest larger amounts should markets fall by 20% or more. This approach avoids the risk of entering an overextended stock market while recognizing the risks of relying solely on market timing.

3. **Seek Out Sophisticated Growth and Income Opportunities:** Most private equity funds require investors to make a commitment and then call capital as they source compelling deals. Investing in private funds requires setting aside liquidity. If you already have that through abundant cash reserves, deploying those funds in private markets over a multi-year period allows you to put money to work slowly and methodically.

   Evergreen Gavekal launched our private investment platform, Evergreen Ventures, in 2020. Since then, our team has been helping clients gain access to high-quality private market opportunities that aim to outperform stocks and bonds. These funds require clients to be comfortable sacrificing liquidity for long periods to participate in more unique, non-publicly traded investments.

Summary

While holding cash can be a prudent strategy during volatile markets, it becomes less effective when markets are stable or strong. It also requires tremendous discipline to follow through on buying when markets dip. After such strength, it is reasonable to assume there will be weakness ahead for stocks, but that doesn't mean it will play out as we envision or that someone sitting on a lot of dry powder will have the confidence to act. As the era of attractive short-term yields may soon end, it's essential to explore alternative investment strategies to avoid letting high cash balances weigh down your portfolio. Whether extending the duration of your fixed-income investments, employing a dollar-cost-averaging approach, or seeking sophisticated growth and income opportunities, taking proactive steps now can help ensure your capital continues to work effectively for you. At Evergreen Gavekal, we are committed to guiding our clients through these transitions, ensuring their investments remain well-positioned for long-term success throughout market cycles.

Reach out to your Wealth Consultant should you have any questions about how to more strategically incorporate money you have kept on the sidelines into your financial plan.

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representation as to its accuracy or completeness.