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INVESTMENT SERVICES

Hymans Robertson Investment Services (HRIS)

Why Cash might not be King

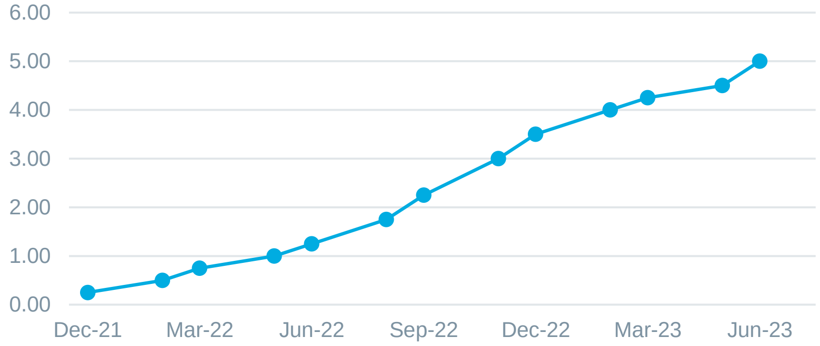
June 2023

- Returns on cash are at their highest rates since 2008. However, although good at supporting capital preservation, cash is no friend of inflation. For example, £100 in 1992, is now worth only £48.
- Timing entry into equity markets is challenging, some of the best days in the market quickly follow the worst days. Had investors missed the 10 best days over the past 30 years, their return would be over 2% p.a. lower than had they been invested for the whole period.
- Over the long-term we expect risk to be rewarded and therefore equity markets to comfortably outperform cash and inflation.

The allure of cash

Following our latest round of engaging conversations with Advisers, a key topic of conversation has been "Is cash now king?". With UK interest rates now at their highest level since 2008 (See chart 1) and market volatility continuing, Advisers are telling us that their clients are finding cash (and money markets as a whole) an increasingly popular option for their savings.

Chart 1: UK Base Rate (%)



Source: Bank of England

Looking back: What history tells us

Holding increased allocations to cash does not come without some challenges and risks.

Firstly, inflation can erode the purchasing power of any cash in the bank. In practice, this means when there is high inflation the same amount of money will buy you less goods and services in the future than it can today. **For example, £100 in the year 1992 is now only worth £48 today, as the same basket of goods is 108% more expensive due to inflation**. To mitigate this, investors need to obtain interest rates on their deposits that are at least the same as prevailing levels of inflation, to ensure that the value of that £100 is maintained for the future.

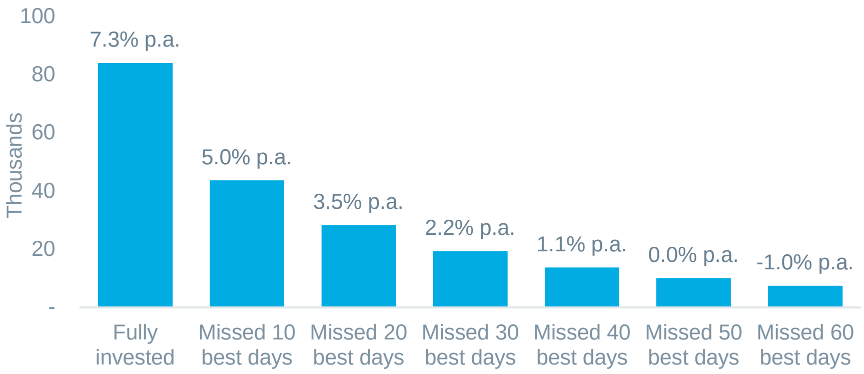


Chart 2: Value of £10,000 invested in the FTSE All Share since 31 December 1992 to 31 December 2022

Source: Datastream

History has also taught us that markets are typically forward looking, and sentiment can shift quickly. For example, the UK's FTSE All Share Index largest daily return over 30 years occurred just after three days of notable poor returns following the Great Financial Crisis of 2008. Chart 2 demonstrates how returns can rapidly diminish when you miss some of the best days invested in the market. This highlights the difficulty of choosing when to redeploy cash reserves, especially if those reserves are locked into a Notice or Fixed-Term savings account.

Whilst we acknowledge that higher levels of cash can help dilute investment risk, it does also mean investors are out of the market. We do allocate to cash within our portfolios but as strategic long-term investors we prefer to reduce risk through carefully considered portfolio construction, ensuring diversification across asset classes, sectors, geographies, and styles. Although past performance should not be used to predict future returns, history does suggest that patience is often rewarded for staying invested during periods of market volatility, as per chart 3, which shows that equities have outperformed cash by almost 600%, or more than 4% per annum, over the last 30 years.

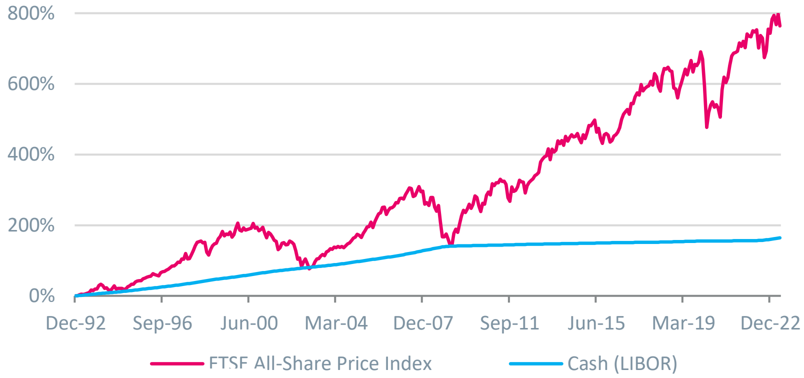


Chart 3: Equity versus Cash Returns

Source: Datastream

Looking forward: Uncertainty creates opportunities

There is no denying that uncertainty remains elevated as central banks grapple with the delicate balance of withdrawing liquidity from the financial system whilst trying to support an already fragile economy from tipping into recession. Despite the unknowns of when inflation and interest rates will normalise, the outlook for risk assets looks increasingly encouraging for long-term investors, as the recent market turmoil has led to many investments now residing at much more attractive valuations levels. As long-term multi-asset investors, this notable uplift gives us reason to be optimistic and also broadens the pallet of investments available for inclusion in our portfolios. We continue to favour a balance of styles and sectors to ensure that we are well positioned for a range of market conditions.

Samantha Kay
Client Portfolio Manager

Risk warning

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