Mitch on the Markets

Money Managers Are Raising Cash, Should You?

By Mitch Zacks
Portfolio Manager

A recent study by Bank of America revealed that money managers have increased cash levels in portfolios to fairly dramatic levels (on a relative basis). According to the research, cash balances rose from 5.5% of assets under management (AUM) to 5.8% in October. Managers cited uncertainties over the election outcome and fears of a bond crisis as their main areas of concern. Whatever their motivations, this marks the highest level of cash held in portfolios since 9/11 and the weeks following the Brexit vote.

An investor may not have a good first reaction to a story about raising cash in portfolios – especially when it's compared to 'levels not seen since 9/11.' But, this is a classic example of a spooky-sounding data point/news headline that tempts investors to react defensively or to follow the herd. In many cases, investors should do just the opposite.

Don't Follow the Herd

We think this is one of those cases. First, it's important to look at the historical data that's right in front of us. The research says that cash balances haven't been this high since 9/11 or the Brexit. So how did the stock market react to those two events? It went up! Indeed, in the three months following 9/11 and the Brexit referendum, the S&P 500 rose by +4.1% and +2.4%, respectively. There was still more bear market left in 2002 following the 9/11 attacks, but managers weren't raising cash because they knew more bear market was ahead. They were raising cash out of fear that 9/11 would immediately send the market tumbling. It didn't.

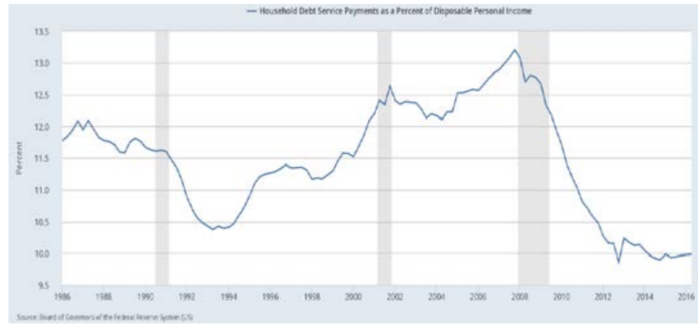
The same applies to the Brexit. Money managers were selling stock to raise cash shortly after the referendum because the result shocked the world. Many believed that Europe and Britain's futures were in serious danger. We wrote at the time that we believed Britain would take a hit, but that nothing would be determined until Article 50 was invoked – which could take months, even years. We cautioned against a knee-jerk reaction to the news as a result, and the stock market has actually climbed steadily since the vote. Raising cash was not the right call.

Plenty of Cash to Go Around

In our view, managers raising cash in portfolios just means there is more available to eventually flow back into stocks. Individual investors are flush, too. Blackrock estimates that investors have up to $70 trillion in cash on the sidelines, with $10 trillion of it earning zero or negative real returns. In Q3, the best performing areas of the market were cyclicals like Materials, Technology, and Industrials. Small cap also outperformed large cap, and foreign outperformed U.S., with notably strong performance in Emerging Markets. This rotation signifies that investors felt comfortable moving further out onto the risk curve, a continuation of which could mean more cash getting put to work – a boon for stocks.

Another useful metric for gauging how well-situated retail investors are for making investments in the stock market is looking at how much of their discretionary income goes toward paying off debt. By that measure, investors are better off today than at any time in the last 30 years. Incomes have been rising slowly, but the ability to refinance debt to lower rates has meant spending less on interest payments and having more free cash to spend elsewhere. A healthy consumer is good for the economy and stocks.

Consumers are Spending Less of Their Incomes on Debt



Do You Have Cash on the Sidelines? It May be Time to Put it to Work

If you have cash in your portfolio that you are unsure how to allocate, you can work with one of our Wealth Management Advisors to generate some ideas for what might work for you. We believe the stock market has more upside from here and that the economy will continue to grow – albeit at a modest pace. But we believe there are still good opportunities in this market, and we would be happy to discuss them with you. If you would like to talk with one of our Wealth Management Advisors to learn more, contact us at 1-800-245-2934.

-**Mitch**

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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