

# Are You Leaving Cash on the Table

Co-authored by *State Street Center for Applied Research* and *State Street Global Advisors Practice Management*

## Key Takeaways

- 40% of the average individual's investable assets are held in cash, despite widespread understanding that investors need to be more aggressively positioned to meet long-term goals.
- The largest factor stopping investors from putting their money into more productive assets is the apparent predictability of cash.
- The desire to understand one's investments and avoid short-term losses can overpower the more important, but less immediate goal of growing a portfolio over the long term.
- Investors and financial advisers should take the opportunity to reshape the cash conversation and focus on achieving a sustainable balance between risk and return.

Investors have parked a significant portion of their investable assets in cash, potentially exposing themselves to a negative real rate of return in the current market environment. This has occurred despite a widespread understanding that investors need to be more aggressively positioned in order to meet long-term goals.

## Too Much Cash: A Long-Term Concern

In our Folklore of Finance study, we find that 40% of the average individual's investable assets are being held in cash.<sup>1</sup> This trend extends across generations. Baby Boomers (1946–1964) say they hold 41% of their assets in cash. Generation X (1965–1980) and Millennials (1981–2000) hold just under 40%.

This isn't just a sign of uncertain times. When asked, as part of our Influential Investor study, what steps they needed to take over the next 10 years to prepare for retirement, 40% of investors said they needed to "become more aggressive." Yet, when asked to project what their asset allocation would look like a decade from now, cash remained the dominant holding in these investors' portfolios. This is problematic because it suggests that many individuals may be unable to reach milestones such as purchasing a home or retiring on schedule.

**Figure 1: Financial Steps for Retirement**



Source: State Street's Center for Applied Research's "Influential Investor" global 2012 study. Primary research sample is based on more than 2,600 individual investors across 14 countries. All percentages are rounded. Within investor results, views of mass basic, mass affluent and high-net-worth are equally weighted.

Percentage of survey respondents by category when asked: Which financial steps are you taking to prepare for or during retirement in the next 10 years, if any?

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### The Good News: Advisers May Be Able to Help

Regularly advised clients have more diversified portfolios, appear to have better protection against risks such as inflation, and are more likely to participate in employer-sponsored retirement plans. They are also more likely to be satisfied with their current investment strategy relative to those who have never been advised. Indeed, nearly 90% of advised investors claim to be satisfied with their investment strategies.

**Figure 2: Are You Satisfied with Your Current Investment Strategy**



Source: Center for Applied Research analysis, as of January 2014.

Meanwhile, only two-thirds of investors who have never had an adviser report satisfaction with their investment strategies.

Advisers do appear to be making a difference in helping clients invest with an eye toward their long-term goals. But even a 32% allocation to cash is likely too high for many investors. In order to continue to address this issue, advisers and investors should first understand its cause.

Investors who have never had a relationship with an adviser hold **49%** of their overall assets in cash.

Investors who work regularly with an adviser have less than **1/3** of their portfolio in cash, likely in part because of their adviser's guidance.

### The Preference for Predictability

We believe that the largest single factor which inhibits investors from putting their savings into more productive assets is the apparent predictability of cash. Cash feels simple, tangible and safe.

**"Investors are outcome-oriented. When the outcome is not predictable, they just go to what is."**

– US Retail Asset Manager

This preference for predictability may also apply to real estate. When investors were asked to identify their best investment to date, 43% listed the purchase of land or property as their top choice. Stocks and bonds came in a distant second, garnering 25% of the vote. Like cash, real estate appears more tangible than other investment options.

The allure of cash and property can also be amplified if an investor's financial situation is complex. Investors with multiple assets, liabilities and accounts can often fall into the trap of dealing with each piece separately rather than aggregating everything into a comprehensive financial plan. This makes it hard to get an accurate snapshot of their true financial picture and their true exposure to cash, real estate and other investments.

### Reshape the Cash Conversation

Investors can work with their advisers to determine what level of risk they are willing and able to accept. Then, together, they can choose investment options that reflect the right approach to achieving their personal goals.

#### Assess Your Cash Position

Most investors should have some level of cash reserves for short-term needs and emergencies. Many planners recommend an emergency fund equal to 3 to 6 months of a client's fixed and variable expenses.<sup>2</sup> But holding on to excess amounts of cash is in itself an investment decision, which is accompanied by its own set of risks.

#### Follow the Numbers

Investors need to understand that the interest received in a bank account, certificate of deposit or money market fund is often exceeded by the rate of inflation. This means that over time, the actual purchasing power of cash and equivalents will usually decrease. Therefore, these supposedly "safe" assets can actually harm investors in the long run.

#### Strike the Right Balance

Fortunately, this may be an opportunity for investors to work with their advisers to develop a better investment strategy. The "dry powder" of these reserve savings may be productively deployed, supplementing current holdings to achieve an acceptable balance between risk and return.

#### Plan Collaboratively

Investors and their advisers should work together to consider all assets and liabilities when creating a financial plan, rather than concentrating only on a particular investment account. This broadened discussion can help identify the tendency to flee to cash or property when a diversified set of investments is actually more appropriate for reaching long-term goals.

<sup>1</sup> State Street's Center for Applied Research's "Folklore of Finance" global 2014 study. Primary research sample is based on more than 2,800 individual investors across 16 countries. All percentages are rounded. Within investor results, views of mass basic, mass affluent and high-net-worth are equally weighted.

<sup>2</sup> Certified Financial Planner Board of Standards Inc. and US Department of Labor's Employee Benefits Security Administration's "Savings Fitness: A Guide to Your Money and Your Financial Future," 2014.

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