MICHAEL SMITH
Head of Research and
Senior Investment advisor

Why US Markets Hold All the Upside Over Cash

Here's why US markets currently hold all the upside over cash and still present a compelling opportunity to build long-term sustainable wealth.

As the US stock market continues its multi-year bull run, equities have proven to be a standout asset class across the last decade. With the key S&P 500 index up 205% since January 2010, investors who have sat on the sidelines for even part of this timeline have likely missed out on exposure to key catalysts driving growth.

What's more, for all their growth, equities have yet to show signs of cooling, with last year representing one of the best calendar years for the stock market in recent history. With this momentum still prevalent, it means that parking your funds in cash could prove to be a costly exercise when you take into consideration the significant opportunity costs.

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'Smart' money is driving the market's momentum

One of the key things spurring on the stock market of late is the strong momentum and a fear of missing out. While markets continue entrenching their strong performance, it is unlikely you'll see investors 'jumping' into cash. On the contrary, however, all the current evidence suggests the opposite is unfolding and that investors are still moving into the stock market as the index tracks higher. Market makers are concerned about missing potential gains that they are prepared to chase those gains and add to the momentum carrying US equities higher.

Bank of America's monthly survey among funds is one indicator used to gauge how much weight fund managers have allocated to various assets. In its most recent survey of 249 funds with US 739 billion in assets under management, fund managers are currently holding the lowest proportion of cash relative to all other assets since March 2013. Cash levels were recorded at 4.2% for the third month in a row.

This comes as the portion of fund managers upbeat about global economic growth this year sits at a two-year high, albeit with the number still representing a minority (36%) that has only risen by 7%. Meanwhile, fund allocation towards global equities has risen to its highest level in 17 months at "net 32% overweight". In addition to growing contributions towards equities, the fact that fund managers have such modest exposure to cash proves that 'smart' money remains bullish as far as the necessity of being in the market right now.

The mechanics of cash are working against fixed savings

One of the major downsides to holding cash is the government cycle of printing funds. This phenomenon is not just isolated to the US, as it is occurring all over the world. However, the US government, courtesy of the world's most important central bank, has the means to continue printing as much money as it wants.

As the effects of printing money are felt over the coming years, this artificial money injection will increase supply, with the prospect of depreciation then weighing on the attractiveness of cash as an asset. In turn, this has the potential to make the stock market even more appealing for both growth and income investors.

The other distinct possibility favouring the stock market ahead of cash is if the trajectory of interest rates turns negative. After years of steady interest rates, the US Federal Reserve has less scope now than in past instances to stimulate growth, even if it has signalled that it feels comfortable with current fiscal policy.

However, US economic growth is in a record 11th year, and while the outlook still remains solid, risk management always needs to be taken into perspective as the budget deficit blows out. If a downturn were to eventuate, and the rate cutting cycle were to resume, it would be starting from a much lower base than prior cycles. Because historically it has taken a full cycle of several percentage points to ignite economic growth, this outcome would raise the prospect of negative interest rates that weigh on cash and bonds, while potentially stimulating equities.

Perpetual outperformance

Above everything else, being in the market over the long-term has consistently proved to be more vital than trying to time the market. While it's easy to pinpoint specific bear markets, these have proven to be short-term blips that otherwise have not stunted the market's overall growth.

The opportunity cost that has accompanied being in cash is significant. US stocks have not only outperformed over the long-term against cash, but when you take into consideration inflation, the real value of holding cash offers little reward for investors who are looking to create sustainable wealth. In fact, you are effectively behind your starting point once inflation kicks in, which underlines the urgency of being in the market to have your capital working smarter.

In the context of markets, cash is mostly seen as a hedging tool, to protect against the risks that come with a falling market. However, the stock market facilitates those same opportunities, with derivatives proving useful to achieve just that. Put options, while not without risk, can ultimately replicate the same protective means against a market downfall, without the inevitability that comes with cash losing its value over time.

The stock market has and always will represent one of the best opportunities to accumulate wealth. Just because it is at a record-high, that doesn't mean it is too late to enter. In fact, now is as good a time as any other. The key is to ensure that you build a well-diversified portfolio, where US equities feature prominently. Riding out the peaks and troughs of the market is best done through global exposure, where weighting towards different segments and companies of significant size can offer substantial upside over the long-run.

International Growth Portfolio - 2019 Update

Index	December Performance	YTD Performance (Nov 2019)
Dow Jones	2.4%	23.66%
NASDAQ	4.4%	36.40%
S&P 500	3.4%	28.34%
Global Growth Portfolio	0.33%	29.44%

Australian Yeild Portfolio - Nov Update

Index	December Performance	YTD Performance (Dec 2019)
ASX 200	-2.36%	18.38%
ALLORDS	-2.10%	19.14%
Australian Yeild Portfolio	-1.20%	2.10% (Oct Inception)

For more information please don't hesitate to get in touch

Michael Smith
Senior Investment Advisor
P: 02 8379 1868
E: m.smith@kauriam.com.au