

SUBJECT: Questions You Were Afraid to Ask #11 – What does it mean to invest in cash?

The only bad question is the one left unasked. That's the premise behind many of my recent letters. Each covers a different investment-related question that many people have but are afraid to ask. In the next few messages of the series, I want to address some questions I've been hearing lately about recent **investing trends**. We'll start with...

Questions You Were Afraid to Ask #11: What does it mean to invest in cash?

Sometimes, an investor will see a headline that mentions the word “cash.” Here are some examples you may have seen:

“Cash is king again.”

“Warren Buffett sits tight on cash.”

“No more ‘cash is trash’ billionaire hedge fund manager says.”

“How much of an investment portfolio should be in cash?”

Headlines like these can cause confusion among new investors. But even experienced investors sometimes wonder: “What does it mean to invest in cash?” After all, we don't usually think of the word “cash” in relation to investing. For most people, cash is the stuff you keep in your wallet. So, what gives?

This is a textbook example of an intelligent question people are often afraid to ask.

Fortunately, “investing in cash” is a fairly simple concept. It means to invest in a type of **short-term security** for a set period of time in exchange for one or more interest-rate payments.

Certificates of deposit (CDs), money market accounts, and treasury bills are three examples. These securities are known as “cash alternative” investments, but the word “cash” alone is often used as an umbrella term to cover all the various types. That's because these types of investments are **liquid**. That means the funds inside them can be converted to actual cash – money you can spend at a moment's notice – quickly and easily compared to stocks, bonds, or investment accounts like a Qualified Retirement Plan (QRP) or Individual Retirement Account (IRA). (Stocks and bonds aren't always easy to sell, and depending on the timing, you may sell for a higher or lower amount than what you paid for. Meanwhile, withdrawing the money from an IRA or QRP before you retire can trigger financial penalties from the government.)

That's why these types of securities are referred to as “investing in cash.” They still provide a return – hence the *investing* part – but also a level of liquidity close to actual, physical currency.

Cash alternatives are handy if you have money that you:

1. **Want to keep safe.** Money markets and certificates of deposit are historically stable investments and are often insured up to a certain point by the Federal Deposit Insurance Corporation.
2. **Want to earn a return on.** In the form of interest rate payments, which are historically higher than with a basic savings account.

3. **Want easy access to within a relatively short period of time.** Many money markets have a maturity of six months or less. Treasury bills mature within one year or less. CDs, meanwhile, usually have a maturity of 6 months to a few years.

That said, there are some downsides to investing in cash alternatives. For one thing, if your focus is on *growing* your money, there are generally better options for that objective. That's why investors may shun putting too much money into cash. They feel there are more productive ways to invest. And while they are very liquid compared to other securities, there are still penalties if you withdraw the money from a CD before maturity. (Money markets don't have an early withdrawal penalty, but many banks and credit unions will charge monthly fees if the balance falls below a certain minimum.)

With all this in mind, why have we seen so many headlines about "cash" in recent years? It is closely tied to interest rates. When the Federal Reserve raises rates, banks and credit unions typically follow suit. As a result, some cash investments will then begin paying higher interest rates than normal. This, coupled with a with market volatility, can cause cash alternatives to gain in popularity with some investors.

How long this trend continues is impossible to know. And it's worth emphasizing that cash, like all securities, is an investment that is *sometimes* right for *some* people in *some* situations...not *always* right for *all* people *all* the time. So, if you're interested in cash investments, be sure to talk about it with a qualified financial professional first to make sure it's right for *you*.

In the meantime, now you know what it means to "invest in cash." In our next message, we'll discuss another recent investing trend. Have a great month!

Sincerely,

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