FAHNESTOCK ASSET MANAGEMENT
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March 29, 2019

Dear Client,

It is often said that cash is king, but why does cash occupy the throne if the other important members of the royal family – stocks, bonds, real estate, commodities – have experienced far superior returns over the last ten years? This is because cash unites the royal family, allowing each asset class to play their own particular roles in investment portfolios and personal finances.

When picturing cash, a stack of green bills or numbers on a bank statement probably comes to mind. However, cash as an asset class includes cash equivalents which are high quality debt securities with near term maturities. They are loans due in less than a year to a credit worthy borrower such as the US government, a municipality or an investment grade corporation. Cash equivalents include treasury bills, commercial paper, marketable securities, money market funds, and short term government bonds.

Risk-averse investors might be attracted to outsized cash positions because the price does not fluctuate and there is the perception of zero risk. This is a false sense of security since every year things get more expensive and the buying power of a dollar decreases. **A large cash position in its simplest form – stuffed under the mattress or in a checking account yielding next to nothing – is currently losing 1.5% in purchasing power annually to inflation.**

Structured properly, cash can yield a return in excess of inflation. The yield on cash equivalents, using three month treasury bills as the most conservative example, has moved pleasantly higher over the last 2-3 years from 0% to a more palatable 2.4% today. Despite relatively low returns and a susceptibility to inflation, cash is an important diversifier in a portfolio. While other asset classes might be zigging and zagging, cash is a stable asset.

The most significant role cash has is as liquidity. Having cash available for financial commitments and living expenses prevents investors from incurring unacceptable losses from untimely sales. Let's say someone is fully invested in stocks and needs to pay for a new roof, a medical bill or a credit card payment. Without cash, they will be forced to liquidate stocks. In good times, this is not a big deal because they will likely receive a fair or even premium price in return. However, in a recession or a bear market they would be forced to liquidate at an inopportune time, likely at a significant discount to intrinsic value. An ample cash position assuages this pitfall.

An extension of this concept is holding cash as "dry powder" which allows for the flexibility to make investments as opportunities arise. An aggressive investor might totally avoid cash when other asset classes are outperforming since the cash position would eat into their potential returns. Unless they are able to perfectly time the ebbs and flows of markets, an impossible task, they would not have cash to purchase investments at a discount in a down market. For a portion of a portfolio, we think it is prudent to sacrifice some potential near term returns in non-cash asset classes in exchange for the potential to buy them later at a lower price. **The best time to go bargain hunting for investments is when you have cash and others are desperate for it.**

Other asset classes can usurp cash's role as king depending on an individual's circumstances. Near term and long term goals, income, cash needs and risk tolerance inform the appropriate big picture allocation and it is different for everyone. Generally speaking, having 0% in cash is just as inappropriate as 100%. We are long term optimists, and in the current political, economic and market climate, we are leaning towards a larger than normal cash allocation in your investment portfolio.

Cash is king because it provides stability, diversification and flexibility in the near term, allowing for potentially more rewarding investments in other asset classes over the long term.

Spring has finally arrived in Summit and despite an easy, mild winter we are looking forward to warm and sunny days ahead! As always, if you have any questions at all, please don't hesitate to reach out. We wish our best to you and yours.

Best Regards,

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