

MARKET SIGHT LINES



It's Time to Develop a Plan to Redeploy Cash

By Michael O'Keefe, *Chief Investment Officer*



With increased bond market volatility and a weakening stock market, it is not surprising that some investors have invested in cash equivalents like money market funds or Treasury bills, as yields on these cash-like investments have exceeded 5%. And yet, when a long-term investor (whether an individual or institution) sets an asset allocation strategy, the corresponding asset mix may not include a significant cash allocation, because cash returns tend to lag stock and bond returns over the long term. So, when cash reserves build up, it is good to ask the question: Is it time to develop a plan to redeploy cash back to my long-term strategy?

In this Sight|Lines, we discuss the rationale for the long-term investor to develop a plan to redeploy cash back to a long-term strategy.

THE TAKEAWAY: AS FEDERAL RESERVE RATE HIKES END, IT MAY BE TIME FOR A PLAN TO REDPLOY CASH.

History shows us that an investor can benefit from a diversified long-term strategy, and now may be a good time to develop a plan to begin reinvesting cash back into such a strategy. In summary:

- The stock-bond portfolio disappointed in 2022, but diversification benefits should return going forward.
- The market and the Federal Reserve (Fed) are signaling no more rate hikes and even rate cuts next year.
- Cash yields often fall once the Fed ends its rate hikes.
- Bonds and stocks have typically posted above-average returns once Fed hikes end.
- Developing a plan, and taking some time, allows the investor to consider new developments.
- A plan can be systematic or opportunistic, depending on your preferences.

This may be a good time to develop a plan to redeploy cash into a long-term investment strategy.

IN-DEPTH: HISTORY TELLS US THAT AS FED RATE HIKES END, A BALANCED, LONG-TERM INVESTMENT STRATEGY MAY BENEFIT.

Long-term investors tend to develop and implement a diversified long-term strategy with a limited allocation to cash. Given economic and market dynamics, now is a good time for long-term investors to develop a plan to begin reinvesting cash. Going deeper:

- The traditional stock-bond strategy disappointed last year, compared to history:
 - In 2022 the S&P 500 Index (stocks) and the Bloomberg U.S. Aggregate Index (bonds) posted negative returns, but in each of the prior 45 years, one or both posted a positive return.
 - With interest rates back to levels last seen before the Great Recession, we believe these diversification benefits should return looking forward.

- There is finally alignment in the market and the Fed forecasts for the fed funds rate:
 - While the possibility for one more 0.25% hike remains, Fed officials have been signaling they may be done with rate hikes, in good part because higher market rates have created the tightening effect they have wanted to cool inflation further.
 - Both the market (fed funds futures) and the Fed's Summary of Economic Projections forecast a fed funds rate lower than current levels at the end of 2024.
- Cash yields typically fall once the Fed ends its rate hikes:
 - In the last four rate hike cycles, three-month T-bill yields have declined 2.3%, on average, over the 18 months following the end of Fed rate hikes.
- Historically, bonds and stocks have posted positive, above-average returns once Fed hikes end:
 - In the last four rate hike cycles, over the first year after hikes end, on average:
 - The Bloomberg U.S. Aggregate returned 11.7%.
 - The S&P 500 returned 16.2%.
 - Cash returned 4.8%.
 - In those four rate hike cycles, over the five years after hikes end, on average:
 - The Bloomberg U.S. Aggregate returned 7.1%, exceeding the long-term average of 4.7%.
 - The S&P 500 returned 8.9%, above the long-term average of 7.9%.
 - Cash returned 3.3%.
- We suggest working with your Stifel Financial Advisor to develop a plan to redeploy cash:
 - A plan will allow you to take some time and consider new developments:
 - We're mindful of increased geopolitical risks and the start of a fiscal transition in our economy, two areas we'll be tracking closely for new developments.
 - Depending on your preferences, your plan can be systematic or opportunistic:
 - A systematic approach, like dollar-cost averaging, allows you to reinvest and rebalance your long-term strategy regularly over a period of time, like 12-24 months.
 - An opportunistic approach extends that, allowing you to engage your Financial Advisor every 1-3 months and invest a regular amount in an area of the market where you agree there is opportunity, even if that means remaining in cash until the next investment date. In our view, the discipline of speaking regularly and being decisive is most important.

CONCLUSION

Cash equivalent yields above 5% have attracted assets, even from long-term investors who usually don't invest in cash consistently. Given Fed and market dynamics, this may be a good time for the long-term investor to develop a plan to redeploy cash as cash returns tend to lag stock and bond returns over the long term.

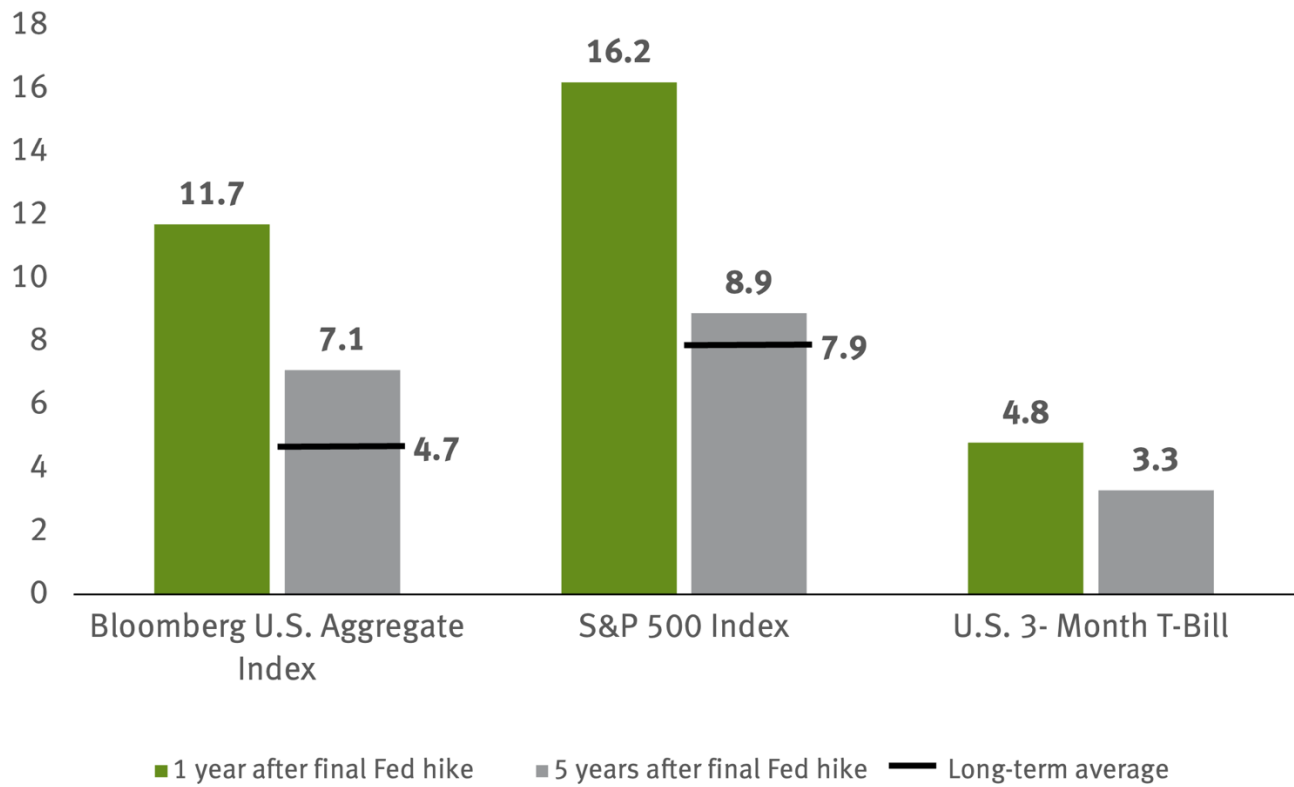
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FIGURE 1. RETURNS AFTER FED HIKES END (%)



Source: Stifel CIO Office via Bloomberg, Capital Group as of October 26, 2023

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Asset allocation and diversification do not ensure a profit and may not protect against loss. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. Due to their narrow focus, sector-based investments typically exhibit greater volatility. Small company stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies. Property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance of real estate companies. Dollar-cost averaging does not assure a profit or protect against a loss. Investors should consider their ability to continue investing during periods of falling prices. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. The Standard & Poor's 500 index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market. The S&P 500 Equal Weight Index is the equal-weight version of the widely regarded Standard & Poor's 500 Index, which is generally considered representative of the U.S. large capitalization market. The index has the same constituents as the capitalization-weighted S&P 500, but each company in the index is allocated a fixed weight of 0.20% at each quarterly rebalancing. The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ. The DJIA was invented by Charles Dow back in 1896. The MSCI EAFE index (Europe, Australasia, and the Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. VIX is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 index options. The Bloomberg U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), and ABS and CMBS (agency and nonagency).

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