October 27, 2023

MARKET SIGHT LINES

It's Time to Develop a Plan to Redeploy Cash

By Michael O'Keeffe, *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.

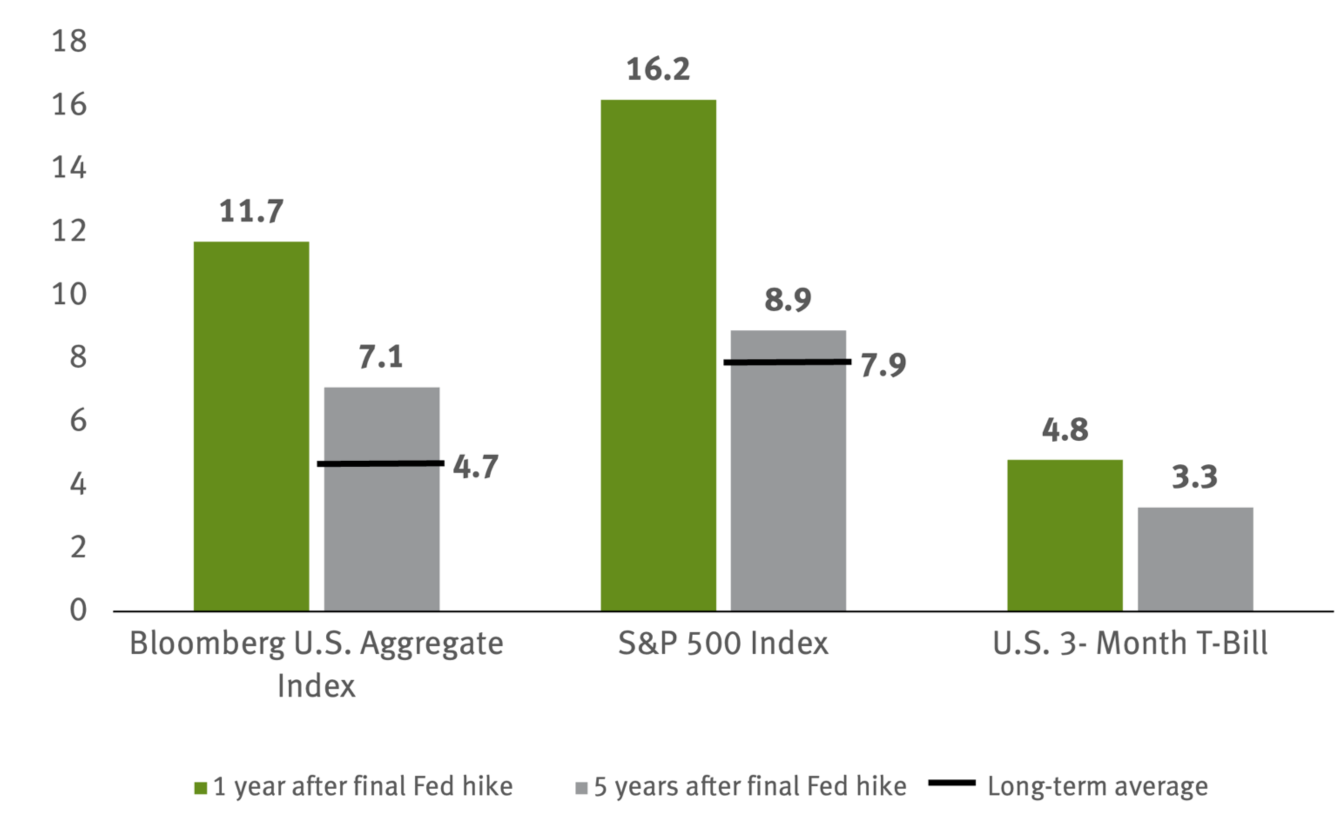
- There is finally alignment in the market and the Fed forecasts for the fed funds rate:
    - While the possibility for one more 0.25% hike remains, Fed officials have been signaling they may be done with rate hikes, in good part because higher market rates have created the tightening effect they have 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 <u>first year</u> 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 <u>five years</u> 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.

Michael P. O'Keeffe, CFA
Chief Investment Officer
michael.okeeffe@stifel.com
www.stifelinsights.com

FIGURE 1. RETURNS AFTER FED HIKES END (%)



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

Stifel, Nicolaus & Company, Incorporated | Member SIPC & NYSE | www.stifel.com

1023.6053618.1