Accredited Wealth Management

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Investment Commentary

September 2023

Stocks around the world fell in the month of August, however, year-to-date (YTD) returns remain strong. Bonds in the U.S. were down for the month but are holding onto small gains for the YTD.

- Persistent inflation, high interest rates, Fed policy uncertainty, and soaring Treasury yields were some of the reasons stocks were down in August.
- The S&P 500 index snapped a five-month winning streak and was down (1.6%). The energy sector was the only index component to advance for the month.
- Foreign stock markets had larger losses for the month, with developed markets down (3.8%) and emerging markets down (6.1%). Concerns about economic growth and higher yields weighed on these markets.
- Economic growth in the U.S. came in at 2.1%, slightly below expectations but strong enough to lower near-term recession fears.
- Annualized headline inflation increased slightly, while core inflation slowed a little. Inflation held steady in Europe and declined in the U.K. but remained well above targets. Prompting the Bank of England to hike rates to a 15-year high.
- U.S. Treasury yields climbed to their highest levels since the financial crisis, and the broad bond market declined for August.

Return (%)	1 MO	3 MO	YTD	1 YR
S&P 500	-1.59	8.28	18.73	15.94
Russell 2000	-5.00	9.00	8.96	4.65
MSCI EAFE	-3.82	3.85	11.35	18.55
MSCI Emerging Markets	-6.13	3.66	4.86	1.69
Bloomberg U.S. Aggregate Bond	-0.64	-1.06	1.37	-1.19

Data as of 8/31/2023, Performance in USD. Source. Morningstar.

The Role of Cash in Portfolios

Cash may not be the sexiest topic to write about, however, since it plays an important role in portfolios it is worth commenting on. In general, investors focused on long-term growth do not need to load up on cash, however, cash can play a vital role for retirees and other investors with shorter-term spending needs.

Some facts about cash:

- Cash isn't just the bills in your wallet. The term is also broadly used to describe other safe and liquid holdings (easily traded) such as Treasury bills, money market funds, and bank accounts.
- There are a lot of cash-like assets out there. According to Morningstar, U.S. households own about $4.2 trillion in checking accounts and U.S. currency, $9.5 trillion in savings accounts and short-term instruments, and $3.2 trillion in money market funds.
- If you added in assets held by corporations, nonprofits, and other organizations, these numbers would be much higher.

What are the advantages and risks of cash?

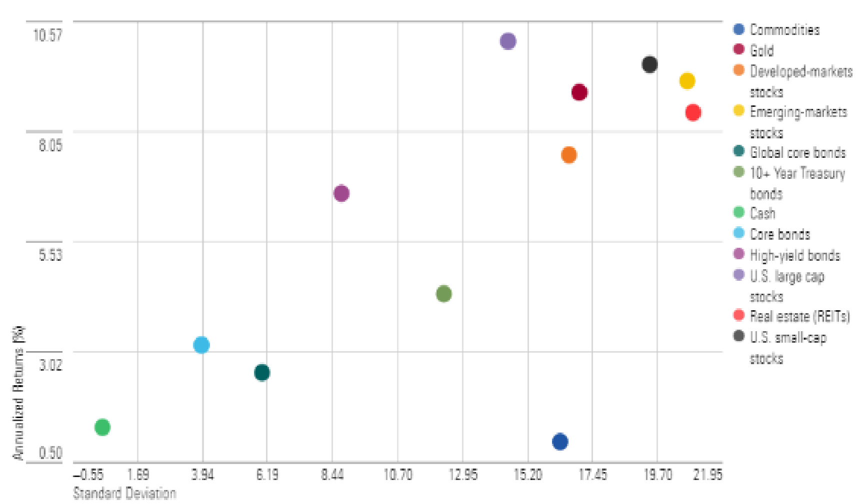
The biggest advantages of cash are safety and liquidity. The U.S. dollar is perceived as a safe asset around the world, mainly because it plays a dominant role in the global economy and is backed by the full faith and credit of the U.S. government. Cash assets are designed to not lose value, at least in nominal terms (before inflation). It is also considered to be the most liquid asset, meaning it is easy to spend. In general, you can easily access cash-like assets, such as checking accounts, savings accounts, and money market accounts to make purchases, pay debts, and transfer assets. The main risk to holding cash is it may not be a good way to stay ahead of inflation. The table below shows the relative returns of cash compared to inflation over multiple time frames. Cash has not kept pace with inflation over the past 20 years, however, over the very long term it holds a slight edge over inflation.

Annualized Returns for Cash vs. Inflation (%)

Benchmark	Year to Date	1 year	3 years	5 years	10 years	15 years	20 years	January 1926 - July 2023
Cash	2.65	3.93	1.38	1.52	0.96	0.68	1.27	3.25
Inflation	3.00	3.18	5.67	3.94	2.73	2.22	2.57	2.95

The 20-year returns for cash assets have been below average due to the Federal Reserve's policy of keeping interest at extreme lows. The chart below clearly shows that over the past 20 years, cash (light green dot) has had both the lowest risk and the lowest returning major asset class. Not much to get excited about!

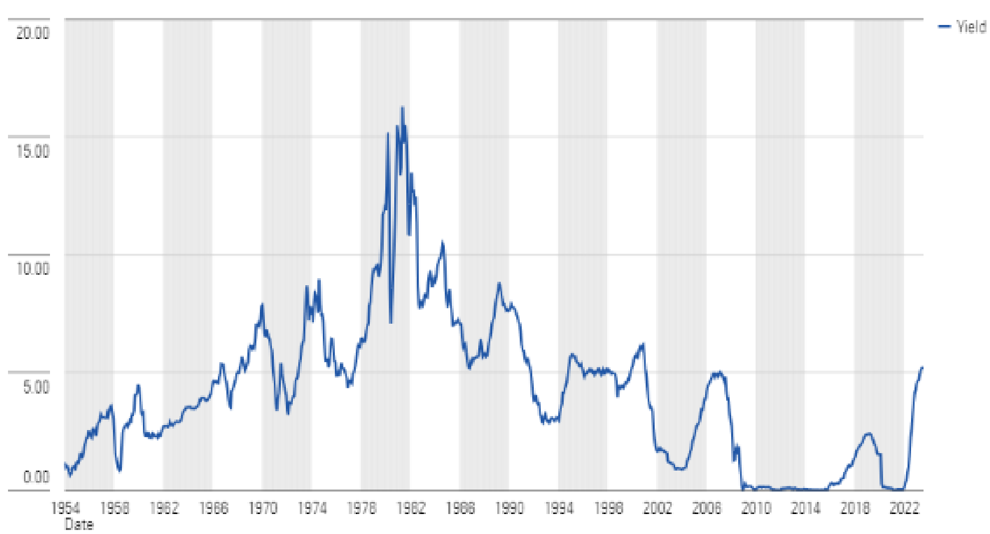
Trailing 20-Year Risk and Return: Cash and Other Assets



It is important to highlight that since the price of cash is fixed and does not appreciate in value, all of the returns are driven by the yield it earns. That is why the Federal Reserve's policy of keeping interest rates so low since the Great Financial Crisis (GFC) kept the return on money market funds and other cash instruments depressed the past 20 years. The 3-month Treasury yield is a pretty good proxy for the yield (return) on cash assets. The chart below illustrates how yields on cash investments became non-existent after the GFC and have only started to normalize in the past 2 years. With current yields on money market funds now over 5%, investors should see better returns on their cash investments, allowing them to have safety, liquidity and a reasonable return.

In contrast, banks and other institutions tend to be slow in raising the interest rate they pay, tending to frustrate their account holders. Therefore, we are seeing a lot of money move out of savings and checking accounts and into investable money market funds in search of better returns. We expect this trend to continue for a while.

3-Month Treasury Bill Yield Since 1954

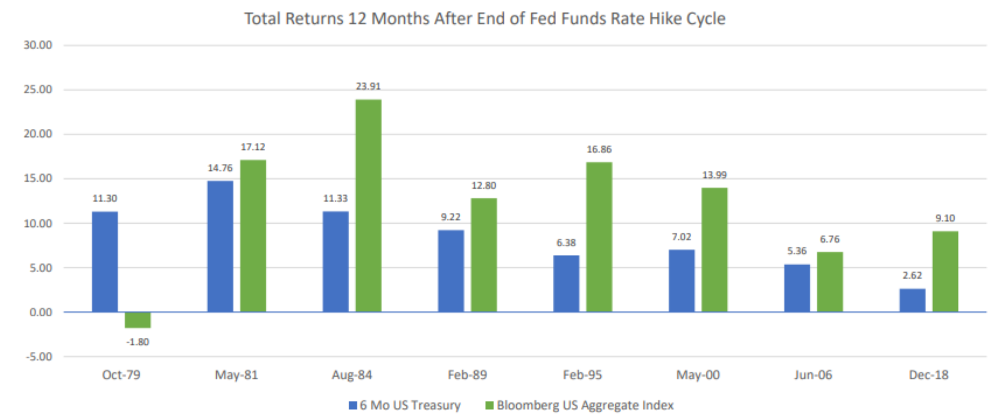


However, before investors get too excited about the higher returns and decide to move all their funds into money market accounts, it is important to realize that the current yield on cash can change quickly. For example, if the economy were to enter a recession in 2024, the Fed could start cutting interest rates and those 5% yields would quickly drop. It is important for investors to strike an appropriate balance between their need for long-term growth assets and shorter-term safety and liquidity assets.

The chart below illustrates that when the Federal Reserve stops hiking interest rates, the return on cash-like investments can sharply lag the return on a diversified bond portfolio. The difference in returns can be substantial, exceeding more than 10% in some of the previous cycles, see the chart below.

Bonds Have Tended to Outperform Cash After the Federal Reserve Stops Hiking Interest Rates

The year that followed a period of rising rates brought improved returns for the bonds relative to cash. In 7 of 8 instances below, bond returns outperformed cash over the 12-month period following the end of the Federal Funds rate hike cycle by an average of 380 bps



In general, we believe cash (money market funds) is the best investment choice for spending needs within a 12-month time frame. However, depending on risk tolerance and financial situation, some investors and especially retirees may want to extend this up to 24-months for peace of mind and a smoother ride in portfolios.

If you have any questions about the return you are generating on cash-like investments at other institutions or how to strike the appropriate balance of short-term and long-term investment strategies, please give us a call.

Best regards,

Steve Giacobbe, CFA, CFP®