Holding Cash Instead of Chasing Investment Returns

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Investing when the market seems to be heading in only one direction (up) is an exciting time for many, but how fast that feeling can change. Bull markets never last forever, and having a plan for market volatility can put you further ahead in the long run. Let's take a look at what investors can do to avoid the hazards of chasing returns by thinking of cash as more than just a boring or an inefficient part of your overall portfolio.

How Cash Factors Into Your Investment Plan

There are two ways you should be thinking of cash and neither consider cash itself as an investment. Most investors already know the primary importance of having cash on hand is to meet upcoming normally recurring expenses for six to 12 months. Does this sound like a longer time frame than you normally hear? It might. But having this additional padding will help you take advantage of the investment part of your portfolio and can help with the second reason investors should include cash as part of a regular investment plan: to buy securities at better prices.

This simple, yet very important, concept can help increase annual returns. An engaged investor should have many ideas about what to buy all the time. With this process in place, a drop of a few percentage points in that investment allows you to get in at a better price. Don't lose patience, wait for the right price to buy. If that buy price is never reached, move on to the next idea. Keeping cash in hand will provide good fuel for better returns on the best investments. (For related reading, see: *5 Tips on When to Buy Your Stock*.)

Don't Let the Fear of Missing Out Affect Your Investments

If everyone in the crowd (market volume) is doing it, does that mean you should be doing it too? Like most things, the tides will turn, things will change and there is often a better time to add new money to your investment holdings. What goes up does come down, and if you notice the smart money leaving the party (institutional investors), you should follow them out the door. This is seen with an overbought relative strength index (RSI) reading (a price that has extended high beyond the norm) or distribution (higher volume on days when the market is down) on a regular basis.

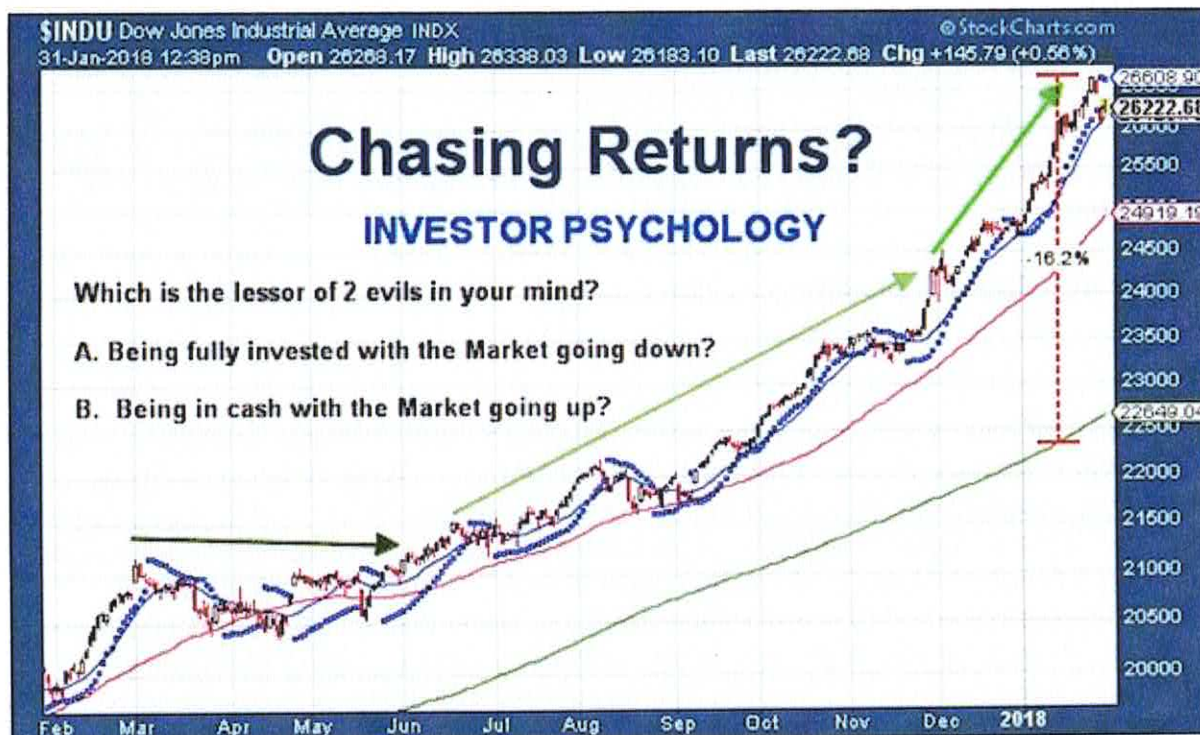
The FOMO (fear of missing out) trade becomes evident as the market continues to move higher. This can remain in place until the irrational exuberance becomes outrageously out of hand. Yet, by looking at the indicators that can help provide a bit of common sense, being greedy when others are fearful and fearful when others are greedy becomes easy. (For related reading, see: *The Financial Markets: When Fear and Greed Take Over*.)

Heed the (Warning) Signs

The signs are everywhere! Some may not be obvious, but when you look back they are history-making events. Think of these well-known bubbles: Tulipmania of the 1600s, the dotcom stocks of the early 2000s, the real estate price (and bond) collapse of 2007.

Review the following chart and start defining who you are as an investor by asking yourself the following question:

Would you rather be fully invested with the market going lower or have cash with the market going higher? Neither I suspect. What would be the lesser of two evils in your mind? It can feel like you are missing out when you have cash in your account and the market is running higher. But chasing that return can prove costly. Being invested with the market going lower is the friend to those that often say, "Buy and hold for the long term." I don't know too many who look forward to getting through a down market just to get to that "long-term" place. (For more from this author, see: *How to Protect Your Portfolio in a Volatile Market*.)



The chart shows the Dow Jones Industrial Average moving higher throughout most of 2017. The slope of the lines with the green arrows continue to increase. The final line is suggesting a move that is nearly vertical. This is the ultimate sign on any chart that it's time to make sure your cash level is increased.

Even when a market continues to go up, investments you have in mind will present better prices. Think of this concept as waiting to get a coupon before you go shopping. Additionally, you will note the amount of white space (showing over a 16% decline potential) before the Dow would even touch the 200-day moving average. Again, this is another sign that without fail, once it moves beyond 15%, better prices should present themselves in the near term. With some diligence and experience, you should be able to feel comfortable with the concept of holding cash while the market is moving higher.

Portfolios Should Manage Cash, Not Invest in It

Be prepared to never waste a good market drop. All portfolios should manage cash to the advantage of buying at better prices. Ask yourself this question: "Can I create a portfolio that can keep up with market returns over time by averaging a cash position of 5%-25% at all times?" If not, you have something to rearrange in your mix right now. If so, you should be on track to generate better investment returns and enjoy a market decline.

Chasing returns (for example, adding more into your 401(k) solely based on the funds that had the best return of the group) may work for period of time. However, getting caught up in the excitement without having a specific plan in mind to rotate your holdings—and doing so by managing cash—can end badly. addressing your greed and fear can go a long way in guiding your portfolio moves and help improve your long-term return.

(For more from this author, see: How Fed Rate Increases Impact Investors.)

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