"We've been carrying probably an excess amount of cash for several years now... It's not because I like cash; I don't. It's a pathetic investment, with the yields you're not making, and it's subject to ongoing depreciation each and every day. But what cash does for me now, and the reason we probably have a little more than we normally would, is that cash creates optionality. And to the extent that you're looking at a volatile world for things that will move in price way more than they move in value, the only way that [we] would be able to respond to those opportunities is by having the cash. So it's not that I like cash, but I do like optionality and I do like the ability to move decisively and quickly when things arise."

Tom Gayner, May 2011

One of the most misunderstood aspects of investing is the role of cash in a portfolio. Cash really is a double-edged sword.

Hold too much cash and you will inevitably see your wealth evaporate. Every thousand dollars invested in the Australian share market five years ago is worth $1,540 today, and has also delivered around $80 of franking credits over that time. A thousand dollars held in cash over the same five years is worth $1,094 today, and buys a lot less than $1,000 did in June 2014. Over the past ten years these comparative outcomes blow out to $2,593 (plus franking credits) and $1,313 respectively! Cash is not a place to hold your wealth over the long term.

On the other hand, hold too little cash and you expose yourself to unnecessary market risk. You might find yourself having to sell investments at unattractive prices just to pay your bills. You are also less likely to have cash available to put to good use in attractive investments at times when the market does become dislocated.

The perfect balance is to hold enough cash to meet your living expenses over the medium term and to take advantage of any opportunities thrown up by the market, but not too much more. Finding that sweet spot will vary with market conditions. Ideally cash balances should be expanding as markets rise (and value is less easy to find) and contracting as better value opportunities appear.

June 2019

Lighthouse Investment Services Pty Ltd as the trustee for the Lighthouse Unit Trust (ABN 14 874 080 673) and
Richard Whan are Authorised Representatives of **Lighthouse Investment Group Pty Ltd** (AFSL 483326)
PO Box 2116 Byron Bay NSW 2481 **Telephone:** 02 6685 3630 **Mobile:** 0409 254 270 **Email:** richard@lighthouseinvestments.com.au