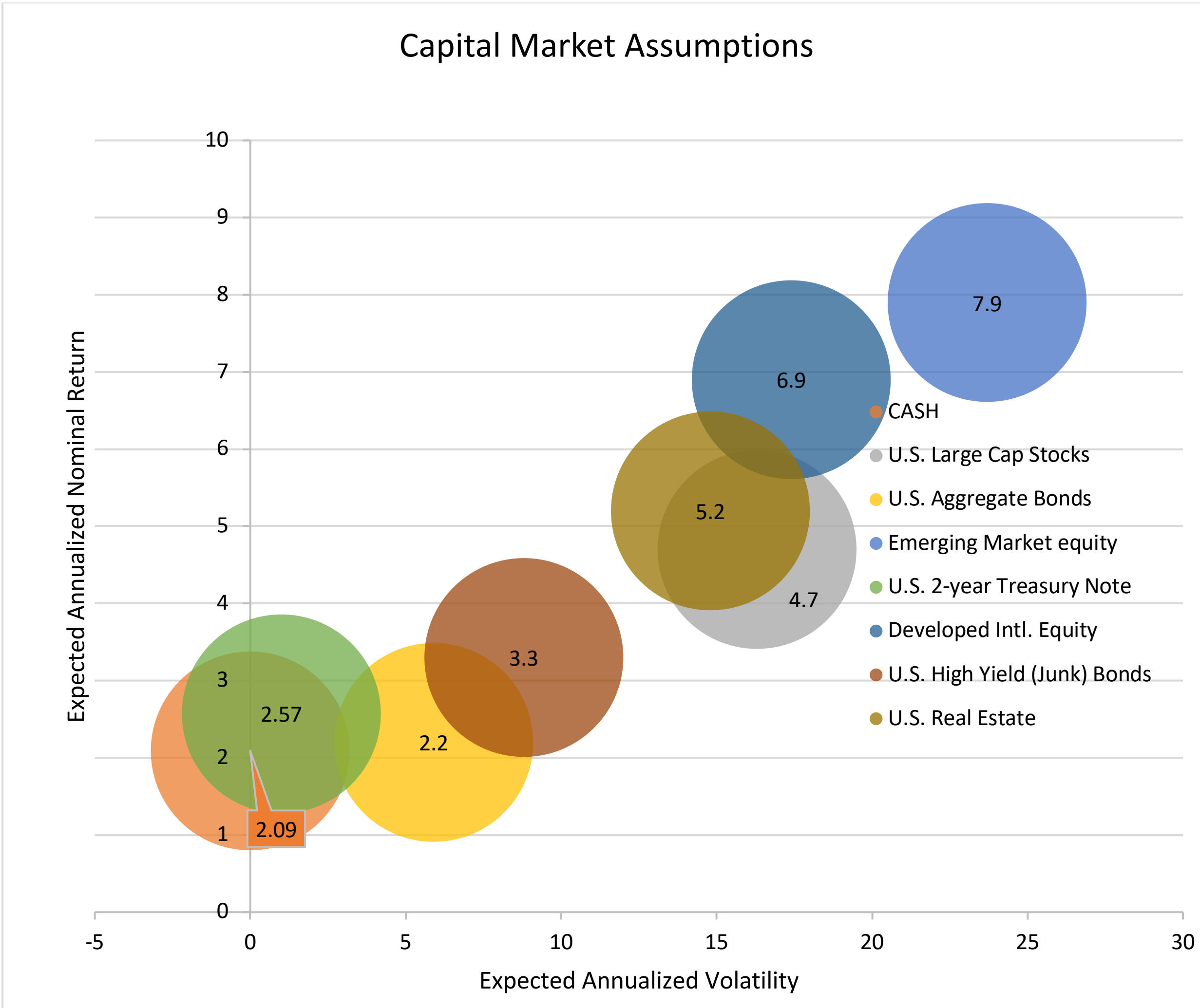
CASH is BACK

By Robert Okada, CFA

Cash is back, maybe not to the levels seen in the 80's, but certainly providing competition to most risk assets. Keep in mind, interest rates in many parts of the developed world remain grounded at zero, so even to have this discussion is a bit of a luxury for dollar-based investors and those domiciled in the USA.

The recent bull market in stocks turned nine years old March 9th, and according to Leuthold Group, is the longest ever ascent and represents the greatest percentage gain in history (+306.5%). Bonds too have come off a thirty-five year bull run in interest rates with the U.S. 10-year Treasury note having bottomed at a yield of 1.32% on July 6, 2016. Currently, the 10-year UST yields 2.98%, and has more than doubled in yield since the low nearly two years ago.

Given most financial assets remain elevated in price, let's compare cash to the expected return on a variety of financial assets. For sake of simplicity, the U.S. 6-month Treasury bill will represent cash, and BlackRock's capital market assumptions from May 2018 will represent return expectations for a select group of asset classes.



Data: BlackRock (5.2018), Bloomberg

Cash represents an attractive option to most asset classes. For example, cash returns are about equal to the return on U.S. aggregate bonds, but without the interest rate risk! Cash at 2.09% now exceeds the dividend yield on the S&P 500, currently at 1.80%. Keep in mind, by owning U.S. stocks investors are anticipating about 2.90% annualized in capital appreciation by holding them. (2.90% capital appreciation + 1.80% dividend yield = 4.7% expected return.) Certainly far from the historical average of about 10% over the last ninety years.

As with any investment comes risk. I prefer to define risk as losing monies, but in this exercise, we'll define risk as volatility (standard deviation), or variability in price. For most investors the more variable the price of an asset, the more "risky" an investment appears. So below, we'll determine how variable each asset class is in relation to its expected return, or coefficient of variation. The higher the number suggests investors assume a higher degree of volatility, or risk, in comparison to the amount of return expected from the investment. We'll sort from best to worst (top to bottom).

Asset Class	Standard Deviation/Volatility (STD)	Expected Return (ER)	STD/ER (Coefficient Of Variation)
CASH	0	2.09%	**0**
U.S. 2-year Treasury Note	2	2.57%	**0.78**
Developed Intl Stocks	17.4	6.90%	2.52
U.S. Junk Bonds	8.8	3.30%	2.67
U.S. Aggregate Bonds	5.9	2.20%	2.68
U.S. Real Estate	14.8	5.2%	2.85
Emerging Market Stocks	22.8	7.90%	2.89
U.S. Large Cap Stocks	16.3	4.70%	**3.47**

Data: BlackRock (5.2018), Bloomberg

In closing, a few very apparent observations stand out from these two simple exercises: Cash and U.S. 2-year Treasuries, currently at 2.57%, represent an attractive alternative to most risk assets, especially when we know the FED has earmarked five additional rate increases between now and year-end 2019. So, cash may be closer to 3.125-3.375%, and the U.S. 2-year Treasury at 3.625-3.875% by year-end 2019. Additionally, U.S. stocks appear highly priced in relation to the other asset classes, while U.S. aggregate and junk bonds appear expensive on both an absolute basis to cash, and relative to international and emerging market stocks.

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