The current market environment provides an opportunity for investors to re-evaluate their liquidity holdings. (UBS)

What should I do with my cash holdings?

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Central bank rate rises have increased the appeal of cash deposits for many investors.

Deposit rates now rival or exceed bond yields and seem a refuge from volatile equity markets. But deposit rates can also fall fast if the rate-hiking cycle turns, and we advise investors to progressively lock in high yields. Over the long term, balanced portfolios outperform deposits over most time horizons.

Cash deposits have become more appealing to many investors as central banks have tightened.

- Cash deposits have come to rival bond yields, with deposits paying 2.5% in the Eurozone versus a 2-year German Bund yield of 2.6%.
- Deposit rates of 4.7% in the US also exceed the 2-year yield of 4.03%.
- Cash at the bank has also seemed like a refuge given recent equity market swings.

But this appeal is superficial, and we favor locking in yields and sticking with a diversified portfolio.

- Deposit rates have the potential to fall fast when central bank policy turns dovish.
- Attractive yields on bonds can be locked in, providing the added benefit of diversification and the potential for capital gains if economies head into recession.
- A balanced portfolio of equities and bonds has historically outperformed cash over most time horizons—with a 60/40 portfolio beating cash around 80% of the time over a five-year period.

So, investors should avoid adding excessively to deposits, favoring bonds.

- We think investors shouldn’t wait for the final rate hike before looking for opportunities to lock in current yields.
- To manage risk, investors could consider averaging into markets, both over time and through gradually lowering the tenor of bond purchases.

- We favor high-quality government and investment grade bonds, which should be more resilient in the event of a recession.

Did you know?

- Inflation has reliably eroded the real value of cash deposits, with a 21% decline in purchasing power for euros since 2007, 23% for US dollars, and 25% for sterling.
- A 60/40 portfolio of US large cap securities and bonds beat cash around 80% of the time over a five-year period, based on data going back to 1926.
- The deposit rate of 3% in the Eurozone compares unfavorably both to the 3.5% yield on the Bloomberg Euro Aggregate Index and more so to the 7.8% earnings yield of Eurozone equities (the 12-month trailing earnings per share divided by the share price).

Investment view

The current market environment provides an opportunity for investors to re-evaluate their liquidity holdings. Those holding too much cash overall may consider averaging into diversified portfolios. Those with adequate liquidity could consider locking in attractive rates in fixed income and benefiting from diversification in the event of a recession. Alternatively, investors can look at fixed-term deposits as another way to capture existing high rates and to minimize the risk from aggressive central bank rate cuts.

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