With cash returns set to fall further as the Fed resumes rate cuts, CIO sees a growing need to deploy excess cash into higher-yielding assets. (UBS)

The growing need to deploy excess cash into higher-yielding assets

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With the Fed set to resume rate cuts imminently and rates in much of Europe already low, the Chief Investment Office (CIO) believes it remains a good time to put cash to work.

Cash is not king. Cash's underperformance against equities, credit, and gold has widened this year, and CIO believes portfolios holding a surplus of cash will likely increasingly underperform those that put cash to work in higher-yielding segments, especially over a longer term horizon. Historically, stocks have beaten cash in 86% and 100% of all 10- and 20-year holding periods, respectively, while the probability of bonds outperforming cash also rises with longer holding periods. Taking on manageable levels of risk with excess cash may improve return potential and help combat the corrosive effects of inflation, in CIO's view.

Quality bonds offer a credible alternative source of portfolio income. Treasury yields have moved lower in recent weeks as markets have grown more convinced that Fed cuts are on the way. But the 10-year yield remains at the higher end of its range since 2008. With initial yield typically a good proxy for longer-term expected returns, CIO expects mid-single-digit returns for medium-duration quality bonds in US dollar terms over the next 12 months. Quality bonds offer robust income and help dampen portfolio volatility, in CIO's view, and they look particularly appealing in a downside scenario. If US economic growth disappoints and data weakens, CIO would expect quality bonds to rally, potentially delivering significant capital gains.

So with cash returns set to fall further as the Fed resumes rate cuts, CIO sees a growing need to deploy excess cash into higher-yielding assets. Phasing into diversified portfolios over time could also help manage the risk of poor timing, reduce the influence of emotion, and provide more opportunities to benefit from market dips and rebounds.

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