CIO believes high grade and investment grade bonds offer attractive risk-reward and can help hedge against downturns. (UBS)

Cash may feel “safe” when stocks fall, but it underperforms on a long-term basis

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While stock market turbulence may boost investor demand for cash, CIO believes investors should seek diverse and durable income sources to insulate portfolios.

CIO believes high-quality bonds offer attractive risk-reward and diversification benefits. We also like diversified fixed income strategies and are watching riskier credit for dislocations.

While cash may feel "safe" when stocks fall, it underperforms on a long-term basis.

- The recent equity market volatility may have increased the temptation for some investors to hide in cash in the near term.
- Yet, stocks have beaten cash in 86% and 100% of all 10- and 20-year holding periods, respectively, and by more than 200x overall in terms of returns since 1926.
- The probability of bonds outperforming cash rises with longer holding periods—from 65% over 12 months to 82%, 85%, and 90% over five, 10, and 20 years, respectively.

Investors should optimize their cash holdings to diversify amid growth risks and lower rates.

- We expect US GDP to grow by close to 1.5% in 2025, but cannot rule out a sharper downturn amid potentially enduring US tariffs and tit-for-tat escalation.
- We now anticipate 100bps of Federal Reserve rate cuts starting in September, pushing down cash rates and with a bias toward even lower cash returns in adverse economic scenarios.

We see various ways to boost portfolio income while reducing portfolio swings.

- We believe high grade and investment grade bonds offer attractive risk-reward and can help hedge against downturns.
- In addition, we like diversified income strategies—such as senior loans, private credit, and equity income—to boost returns and resilience.
- Furthermore, systematically phasing cash into diversified portfolios, including through building-block approaches, can help average costs, buy markets on dips, and build long-term positions.
- Income-seeking investors can also consider structured strategies like reverse convertibles to generate yield from equities and potentially buy stocks at better prices during market uncertainty.

Did you know?

- We believe investors should set aside funds in cash, bonds, and borrowing capacity to help them meet expenses over the next three to five years and to meet these expenses even in the event of bear markets.
- Money earmarked for spending in the next 6-12 months should be held in assets with minimal market, liquidity, and credit/counterparty risks, in our view, given little time for recovery if markets are volatile.
- Bond ladders, by matching investment assets to future liabilities, can help to manage interest rate and market risk, putting capital preservation ahead of return potential.

Investment view

Putting excess cash to work and seeking durable income should remain a strategic priority for investors, in our view. Government and investment grade bonds look particularly appealing in tariff-induced volatility and with recession risks elevated. Long-term investors can consider diversified fixed income, senior loans, private credit, equity income strategies, and structured strategies as sources of yield. Investors must consider the risks before investing in alternative assets, including illiquidity.

Original report - **How should investors put cash to work?, 19 May 2025.**

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