

# The Hidden Value of Cash

While it may seem very painful to hold cash when it is yielding near 0%, it does offer two sources of value. The first and obvious value is that it offers protection against volatility. The second value is perhaps less clear but possibly more valuable. Cash gives investors valuable options.

## How do we define cash?

What we call cash is not the paper money in your wallet. Cash in investment portfolios is actually invested in money market funds. These funds are invested in ultra short-term bond and fixed income instruments. Money market funds offer a floating rate yield and are considered near cash because shares are always redeemable at \$1<sup>1</sup>.

## Investment Risks Come in Many Colors

The risk that Wall Street and the popular media focus on is price volatility. This myopic focus on near term price gyrations creates opportunity for investors who can ignore short-term frantic swings from fear to greed, and back again. Prices eventually follow fundamentals such as cash flows and a company's earnings growth. We often tell clients that for their longer term needs, volatility risk should fall far down on the rank order of risk worries -- well behind inflation risk. When saving for retirement, what does one care if a stock goes up and down 10% or 15% on a monthly basis if over time one can earn a return significantly higher than the rate of inflation?

For investors with spending needs in the near term, however, volatility risk does matter. Our definition of the near term is the next 3 to 5 years. Cash will not lose nominal principal value in a rising rate environment. In fact, due to the short term investments held by money market funds, the yield on cash rises quickly allowing investors to benefit from the higher rate.

Conversely intermediate and longer maturity bonds, falsely thought of by many as 'conservative' investments in any market, will lose value as rates rise. This protection against near term price swings and rising interest rates has a 'hedge' value that is masked by the near 0% current yield.

## Cash Has Many Options

Although not obvious, cash gives investors tremendous options. Holding cash in a falling stock market gives investors the option to purchase companies at a discounted price. With the recent volatility of stock prices, the value of this cash option increases. Cash also provides options in a rising interest rate environment. As bond yield rise, investors get the opportunity to purchase bonds at higher yields. Bottom line: cash has value that is masked by ultra-low current yield.

## Market Log- April 13, 2012

S&P 500: 1370.26  
10 year T-Note: 1.98%  
Crude Oil: \$102.83  
Gold: \$1660.20

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One Portland Square, 5th Floor  
P.O. Box 31  
Portland, ME 04112

207 772 3761 [www.hmpayson.com](http://www.hmpayson.com)

<sup>1</sup> This feature is currently being reviewed by the SEC....