With the global rate-cutting cycle underway, investors should re-evaluate their cash holdings, lock in yields, and ensure they are sufficiently invested and diversified. (UBS)

What should I do with my cash holdings?

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Current returns on cash will not be available for much longer if central banks continue to cut rates. Investors holding cash or money market funds (or those with expiring fixed-term deposits) need to manage their liquidity accordingly. We think bond ladder strategies can help investors retain attractive yields, while structured investment strategies can provide exposure to market gains alongside a degree of capital preservation.

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. To cover net expected portfolio withdrawals over the next one to three years, investors can consider buying a series of individual short-duration bonds of varying maturities (bond ladders), staggering their expiry to provide a steady stream of income. We see the reinvestment risk from holding cash as greater than the potential gains from waiting for better bond prices, and therefore recommend investors to take steps to lock in currently attractive bond yields. We project 10-year US Treasury yields to decline to 3.85% by the end of the year and 3.5% by March 2025.

What you need to know about CIO's House View

The global trend of rate cuts has begun.

- In March, the Swiss National Bank became the first major central bank to lower rates. It surprised markets again with its second rate cut in June.
- Sweden's Riksbank, the Bank of Canada, and the European Central Bank have also reduced rates. We expect the Bank of England to join this trend with a rate cut in August.
- For the Federal Reserve, our base case is for two 25-basis-point cuts this year, starting from September.

Cash looks set to deliver progressively lower returns.

- Historically, cash only outperformed bonds early in the hiking cycle—as we saw in 2022—with global bonds starting to outperform even before rates peaked.
- We think markets are underestimating the likely number of cuts over the cycle. In their latest projections, Fed officials put their estimate of the longer-run fed funds rate at 2.8%.

Investors need to consider options for their liquidity.

- Bond ladder strategies can help investors lock in attractive yields over the next few years.
- Investors can also consider structured investment strategies with capital preservation features, which allow for a degree of safety alongside the potential for market gains.
- High-quality corporate and government bonds are another attractive destination for investors deploying cash.

Investment view

We believe investors should limit their overall cash balances, as falling interest rates this year should reduce the return of cash and increase reinvestment risks. Quality bond ladders and structured investment strategies with capital preservation features can offer investors some of the certainty provided by cash, but with higher return potential as rates fall.

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Read full report UBS House View Briefcase: What should I do with my cash holdings? 8 July 2024

Important information