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With interest rates likely to fall in 2024, investors should reevaluate their cash holdings, progressively lock in yields, and ensure they are sufficiently invested and diversified. (UBS)

Is it time to reduce my cash holdings?

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In recent years, rising central bank policy rates have increased the appeal of cash. But interest rates are set to fall in 2024, with the Federal Reserve removing the tightening bias in the latest FOMC statement. This reduces the potential return of cash and increases reinvestment risk.

CIO believes investors should progressively lock in yields while these are available, and ensure they are sufficiently invested and diversified for the long term.

The rate-hike cycle of 2022 and 2023 increased the appeal of cash deposits for many investors.

- In the US, the federal funds rate target range stands at 5.25–5.5%. In the Eurozone, the deposit rate is 4%.
- The European Central Bank, the Federal Reserve, and the Bank of England all left policy rates unchanged in their first meetings of the year.

But such elevated deposit rates may not last too long.

- The latest FOMC statement removed the tightening bias as the risks to achieving its employment and inflation goals are moving into better balance.
- Our base case is of an economic soft landing in the US, and we see the Fed cutting rates by 100bps this year, likely starting in May.
- The BoE gave a more balanced outlook, with policymakers leaving the impression that the door to rate cuts is open. The overall tone from the ECB was also softer than in December.

So, investors should re-evaluate their cash holdings, lock in yields, and stay invested and diversified.

- Attractive yields on quality bonds can be locked in, providing the added benefits of diversification and potential capital gains.
- A combination of fixed-term deposits, a bond ladder, and select structured investment strategies can help investors optimize yields while balancing counterparty, interest rate, credit, and liquidity risks.
- We believe assets in excess of 2–5 years of expected withdrawals should be invested in a diversified range of longer-duration financial assets.

Did you know ?

- History suggests that peak rates don't last long. In the 10 instances of Fed rate-hike cycles since 1970, interest rates stayed at the peak for a median of three months.
- 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.
- Historically, cash has only outperformed bonds early in the hiking cycle—as we saw in 2022—with global bonds starting to outperform even before rates peaked.

Investment view

We believe investors should limit their overall cash balances in the year ahead. Interest rates are likely to fall in 2024, potentially sharply. This will reduce the return of cash and increase reinvestment risks. Beyond cash and money market funds, investors should diversify their liquidity strategy with a combination of fixed term deposits, bond ladders, and structured investment strategies to cover expected portfolio withdrawals over the next five years.

Main contributors - Daisy Tseng, Vincent Heaney, Christopher Swann

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