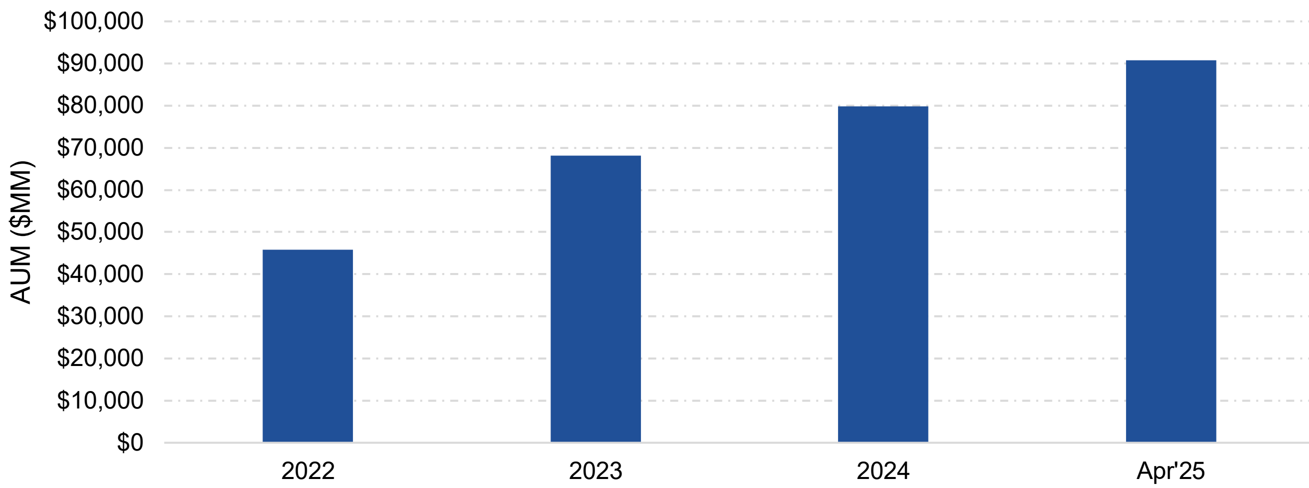
Putting cash to work

Why are we sitting on so much cash?

Does your investment portfolio have a higher allocation to cash than usual? If you answer yes, you're not alone. Canadians have indeed been packing their pockets with more cash over the past few years, and even more so in the early months of 2025. For context, in Canada, Money Market Funds now account for approximately $90 billion in total assets, up from $80 billion at the beginning of the year. This is on top of the approximate $11 billion increase from 2023 to 2024.

Canadian investment industry – money market AUM



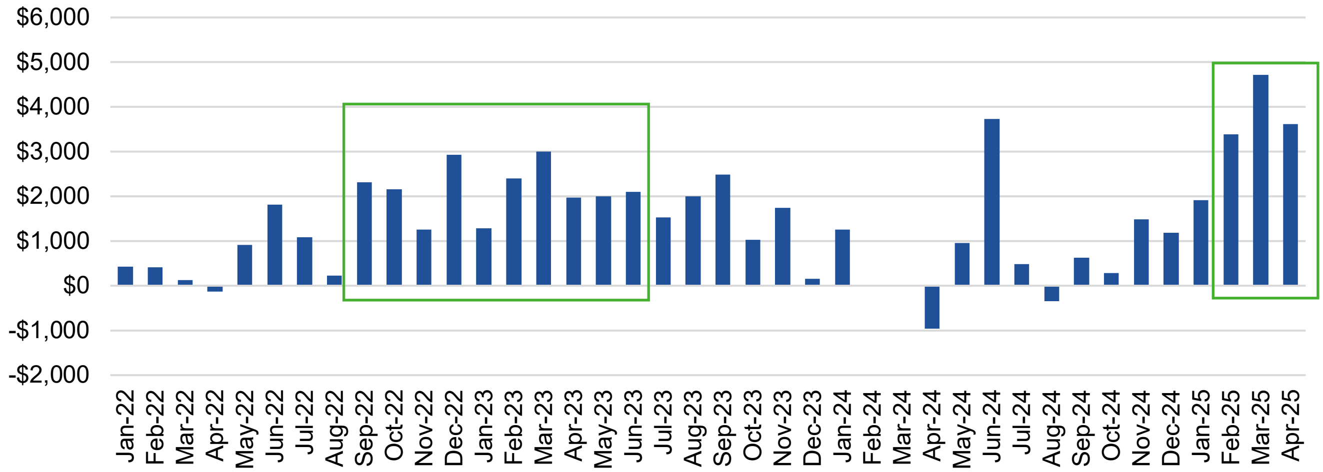
Source: SimFund (April 2025).

And this story is not unique to Canada. In fact, according to ICI, money market assets in the U.S. have reached a record-breaking level, surpassing $7.4 trillion by mid-June 2025.

So, what's behind investors' new affinity for cash? It's highly likely a combination of shifts in monetary policy, a changing macroeconomic environment, and most importantly investor sentiment perhaps becoming more risk-averse.

Post the COVID-19 backdrop of 2020-2021, the global economy rebounded strongly, leading to central banks aggressively raising interest rates to combat inflation. For context, the U.S. Federal Reserve (Fed) raised the fed funds rate from 0.25% in 2022 to over 5.25%. Unsurprisingly, investors shifted cash into HISA's and money market funds to capture higher returns with relatively minimal risk. At the same time, headlines focusing on the Russia/Ukraine war and recession fears, have made investors more defensive. And, of course, more recently it has become tariffs and trade tension, and heightened geopolitical risk in the Middle East that has captured the attention of investors. Evidence of this can be seen in the chart below, where inflows into money market funds during February, March and April 2025 were at their highest level over the past 3.5 years.

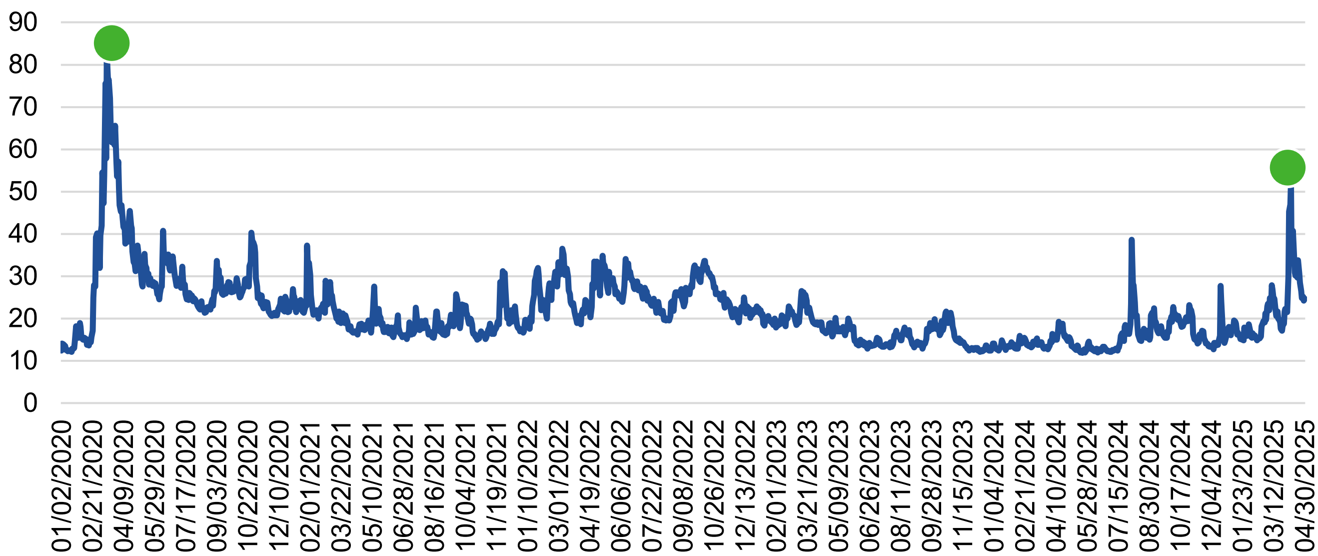
Canadian investment industry – money market flows



Source: SimFund (April 2025).

We also saw the VIX Index, used as a barometer for market uncertainty, at levels not seen since the COVID-19 era, showing evidence of fear among investors. Money market funds offer a “wait and see” parking spot for cash during uncertain times.

Tariff uncertainty ignites fear - VIX Index (Jan 2020 – Apr 2025)



Source: CBOE

Are we being smart with this cash?

Okay, so we now have an idea why we may be holding more cash in our portfolios. But what is the right amount? Could this cash be burning a hole in our investment portfolio pocket? We know that cash plays an essential role in many investment portfolios. It provides a reliable source for paying bills and covering short-term goals, which is why it's crucial to keep enough on hand to meet your immediate financial needs.

As we have seen from the discussion earlier, having cash readily available can help cushion your portfolio during market volatility by reducing overall risk, especially in uncertain economic conditions.

However, holding too much cash can work against you, depending on your reasons for doing so. Emotional factors often influence financial decisions more than we realize. Cognitive and emotional biases can play a role. One common example is loss aversion—where the fear of losing money outweighs the excitement of potential gains.

For some, this can lead to prematurely pulling out of investments during downturns. For others, it might mean avoiding stocks or growth-oriented assets altogether. Over time, this cautious approach can result in an overly conservative, cash-heavy portfolio—potentially missing out on better long-term returns.

The takeaway: **Striking the right balance** between liquidity and growth is key. Your cash allocation should reflect both your short-term needs and your long-term financial goals.

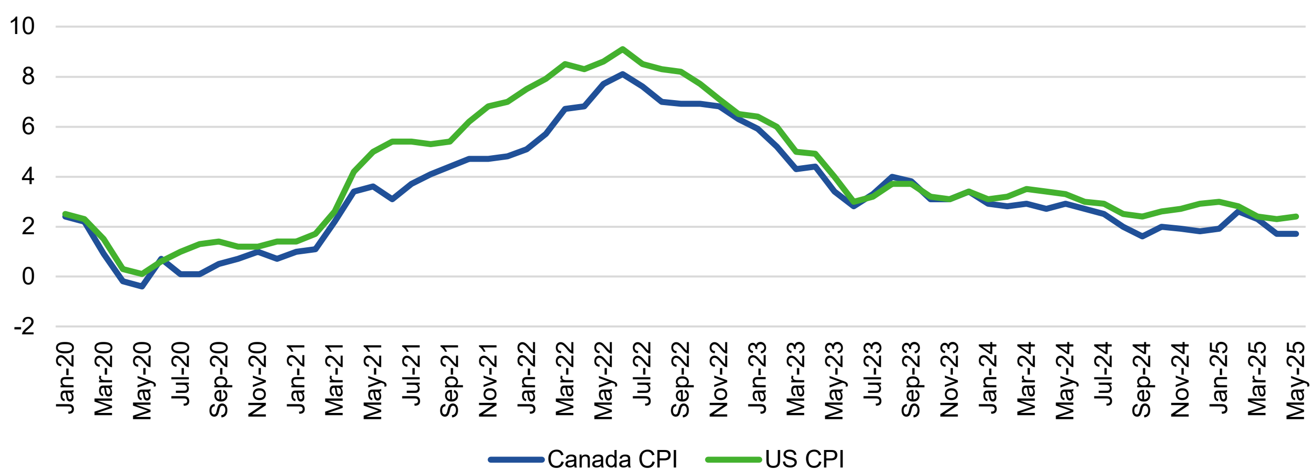
Get your cash working for you!

Listen, you work hard. So should your cash. It's prudent to keep enough short-term investments on hand for any foreseeable needs over the next 2-3 years but beyond that, investing it may be a wiser choice. Let's look at a couple of reason why:

Inflation will eat your lunch: how holding cash can cost you over time

Just like volatility and macroeconomic uncertainty, inflation also reared its ugly head post the COVID-19 era, with CPI becoming elevated in both Canada and the U.S. And while it has come off the boil of the 8%+ levels of June 2022, it is still simmering, limiting the ability of the Bank of Canada and U.S. Fed to lower interest rates further.

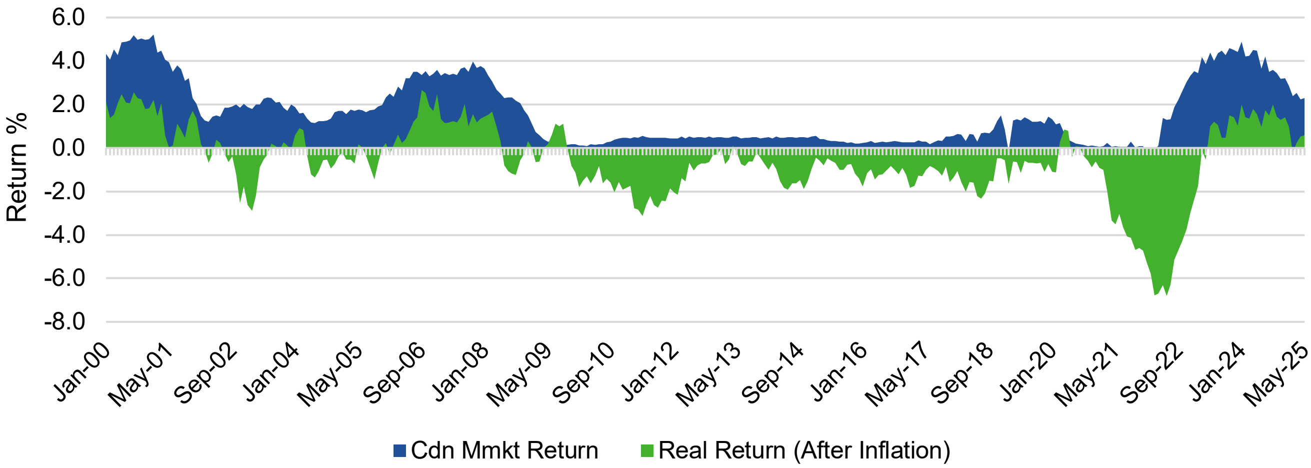
Inflation eases, but the fight isn't over



Source: Statistics Canada; U.S. Bureau of Labor Statistics (May 31, 2025)

Cash and other short-term investments like money market funds usually fall short when it comes to real returns—that is, returns after inflation is considered. That's because they invest in super low-risk, short-term things like Treasury bills, bankers' acceptances and commercial paper, which do not pay much interest to begin with. When inflation is running even just a bit hot, it can eat up most or all of those small returns. And if you're paying taxes on the interest you do earn, that shrinks your earnings even more, sometimes leaving you with a return that's flat or even negative in real terms.

When safe investments turn negative



Source: Morningstar Direct; Statistics Canada (May 31, 2025).

That said, money market funds are not really meant to grow your money – they're more about keeping it safe and easily accessible. They are like a parking spot for your cash while you figure out what to do next or wait for a better investment opportunity. So, while they are useful for managing short-term cash or reducing risk in a portfolio, they're not the best place to be if you're trying to stay ahead of inflation or grow your money over the long run.

Here is another way to look at it. As mentioned, cash tends to lose value over time due to inflation. As prices rise, each dollar buys less – meaning your purchasing power declines. While the dollar amount in your account may stay the same, its ability to buy goods and services gradually erodes.

This loss of purchasing power can become significant. If you are not investing in assets like equities and fixed income, your money misses out on growth opportunities that could outpace inflation. For instance, with an average inflation rate of 3%, the value of $100,000 shrinks meaningfully over time:

- After 5 years: $86,260 (14% loss)
- After 10 years: $74,400 (26% loss)
- After 15 years: $64,186 (36% loss)
- After 20 years: $55,368 (45% loss)

Imagine a 45% decline after 20 years – just by being too conservative and choosing to hold cash. Understanding inflation's impact is essential.

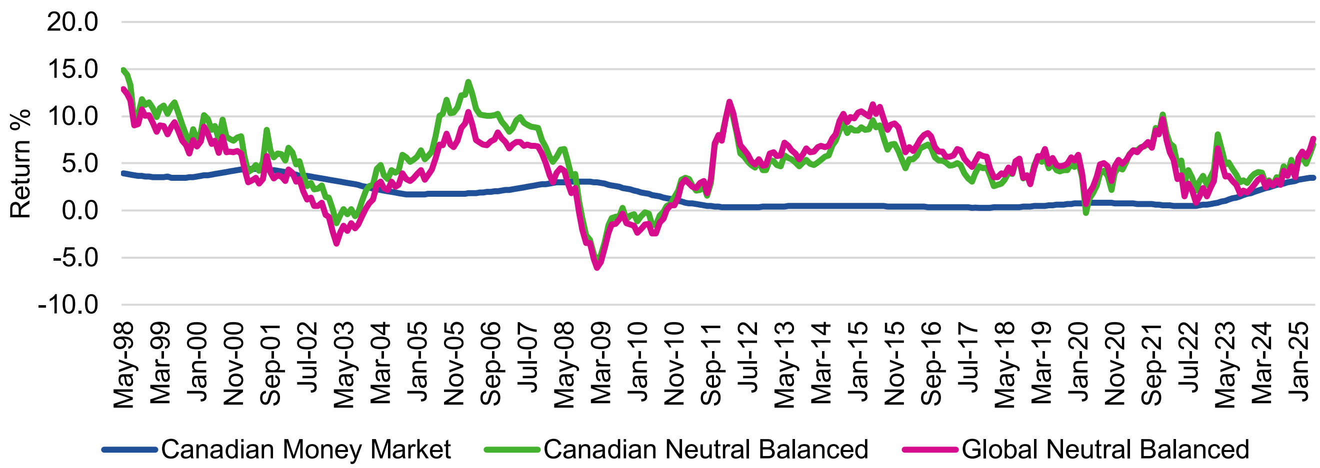
Bottom line: A portfolio made up entirely of cash is not risk-free. Over time, inflation can quietly but powerfully diminish your wealth.

Take a balanced approach to improve long-term performance

Balanced funds are likely to outperform cash over the long term because they are designed to generate growth by investing in a diversified mix of stocks and bonds, while cash (or cash equivalents like money market funds) is focused solely on preserving capital and providing liquidity, not growing it.

As an example, let's look at the performance of a money market investment vs. investing in a balanced fund (both Canadian and Global) over the past 30 years. Assuming an investment time horizon of at least 3 years, you can see from the chart below that aside from three recessionary periods (early 1990's, the great recession, and COVID-19), balanced funds have significantly outperformed cash investments on a 3yr-rolling basis.

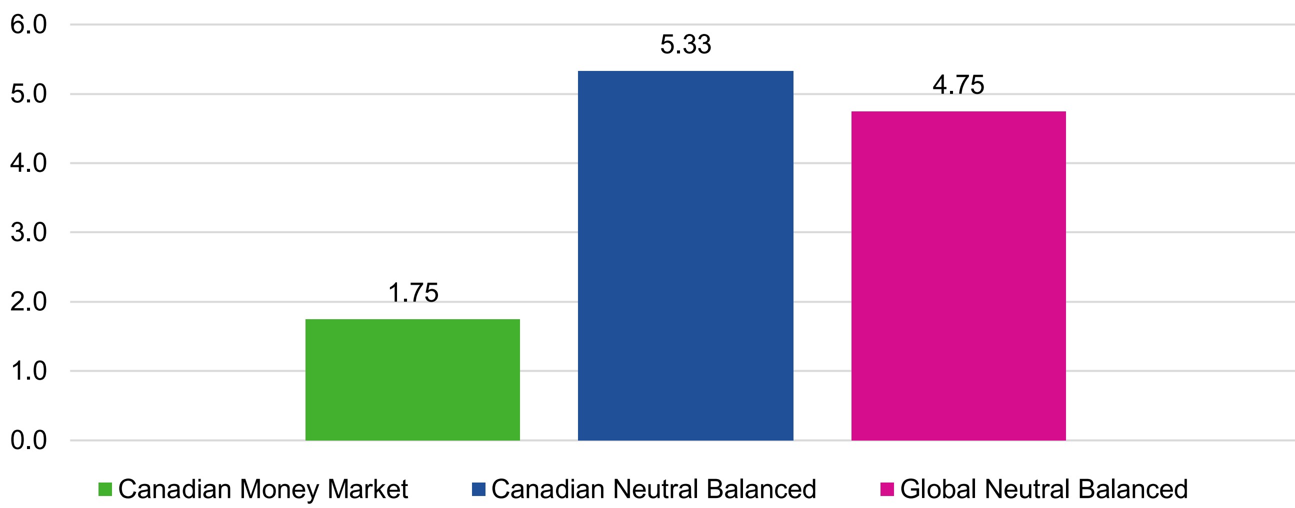
Rolling 3-year returns



Source: Morningstar Direct

The average 3-year return of a money market investment over this 30-year period from June 1995 – May 2025 was 1.75%. This compares to the Morningstar Canadian Neutral Balanced category posted a return of 5.33% and the Morningstar Global Neutral Balanced category return of 4.75%.

Average 3-year return (1995-2025)



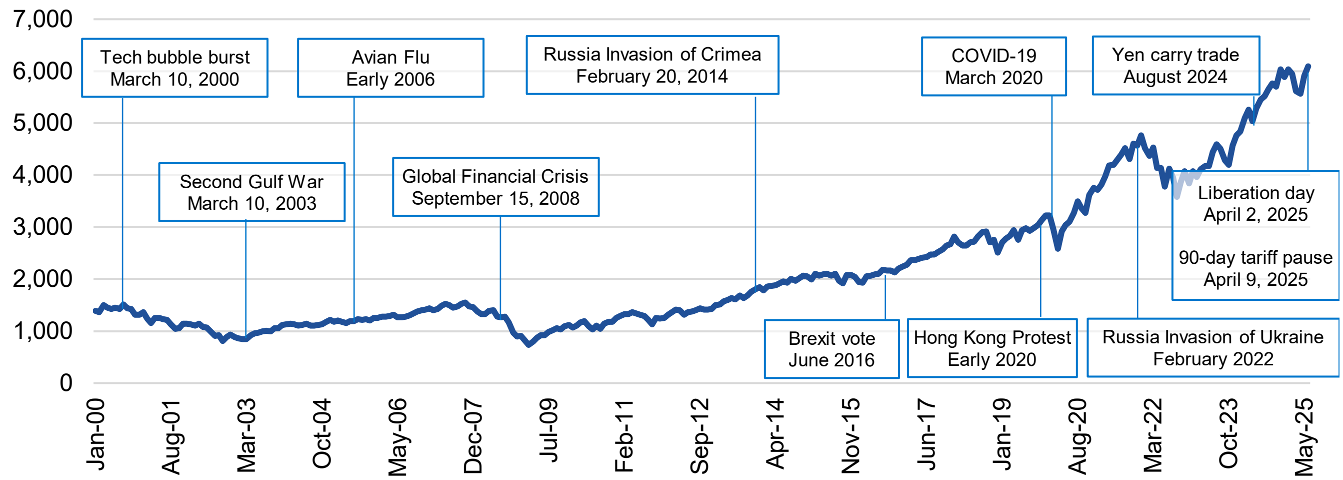
Source: Morningstar Direct

Stocks in balanced funds typically provide higher returns over time because they represent ownership in companies with the potential for earnings growth and capital appreciation. Bonds, while generally more conservative, offer higher yields than cash and help smooth out volatility. This combination gives balanced funds a good balance of risk and return. Cash, on the other hand, earns very low interest—often below inflation—so its purchasing power declines over time. In short, balanced funds take on more risk, but they also offer much better chances of growing your money and beating inflation over the long haul.

Is now the right time to invest?

Investors may be nervous right now due to a mix of economic, policy and geopolitical uncertainties. Will inflation persist? Will trade wars and tariff pressures linger? Will global conflict intensify? The truth is, investment markets are always climbing some “wall of worry”—this time is no different.

The case for staying invested – S&P 500 Index level (USD)



Source: Morningstar Direct

The phrase “it’s always a good time to invest” is rooted in the idea that long-term investing works best when you stay consistent, rather than trying to perfectly time the market.

Here’s why that mindset makes sense.

Trying to buy or sell at the "perfect moment" often backfires because markets are unpredictable in the short term. Here is a perfect example: The S&P 500 Index reached its lowest point of 2025 on April 8, 2025, closing at 4,982.77. This marked an 18.9% decline from its all-time high of 6,144.15 on February 19, 2025. The sharp decline was primarily driven by escalating trade tensions, particularly following the “Liberation Day” implementation of a reciprocal tariffs by President Donald Trump, which led to retaliatory measures from other countries and significant market volatility. Since then, the market has experienced a recovery, with the S&P 500 rebounding to close to 6,100 by June 24, 2025, reflecting an approximately 22.4% gain from the April 8 low. If you had sold your U.S. equity investments on April 8, you would have missed out on this significant rebound.

Historically, investors who stay invested through ups and downs tend to come out ahead. The longer your money is invested, the more you benefit from compound growth, where your gains earn additional gains. While markets go through cycles—including recessions and bear markets—the long-term trend is upward. That’s because economies grow, companies innovate, and productivity improves over time. By investing regularly (e.g., through dollar-cost averaging), you spread out your risk and take advantage of both highs and lows.