Why Holding Too Much Cash on the Sidelines Can Set You Back

T. Rowe Price
INVEST WITH CONFIDENCE

Having too much cash sitting on the sidelines in a money market fund might seem like a safe move. But history shows there's an opportunity cost to playing it too safe. Simply put, cash has less growth potential and most likely won't help you reach your long-term goals. Here's some practical advice to help you stay invested and funnel idle cash back into the market in a prudent way.

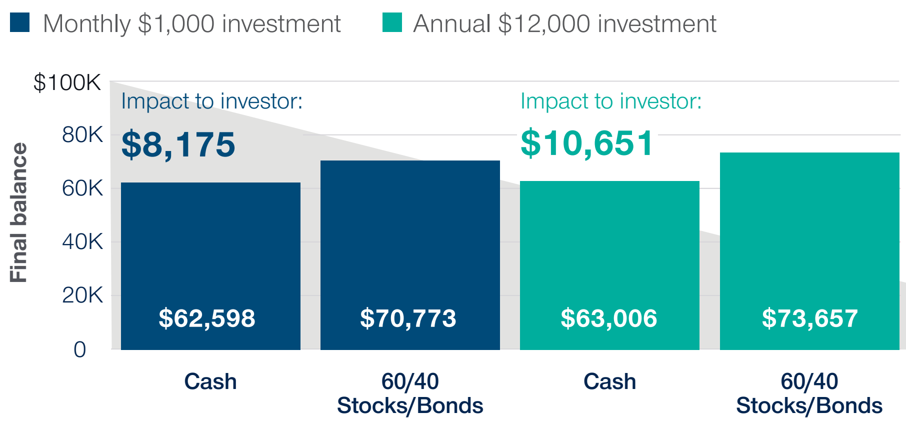
The opportunity cost of holding cash

The bar charts below show how little growth an all-cash portfolio produced compared with a traditional 60/40 balanced portfolio over five years and then extended over three decades. Investors who employed a systematic investing approach and regularly contributed to a diversified investment account with a healthy mix of stocks and bonds generated much higher returns. The all-cash investor, despite the perceived safety of cash, left a lot of money on the table. Even with periodic market downturns, history shows that markets eventually rebound, recoup their losses, and ultimately move higher and outperform cash by a wide margin. A systematic approach to investing helps control emotions, puts your savings on autopilot, and allows you to benefit from compounded returns.

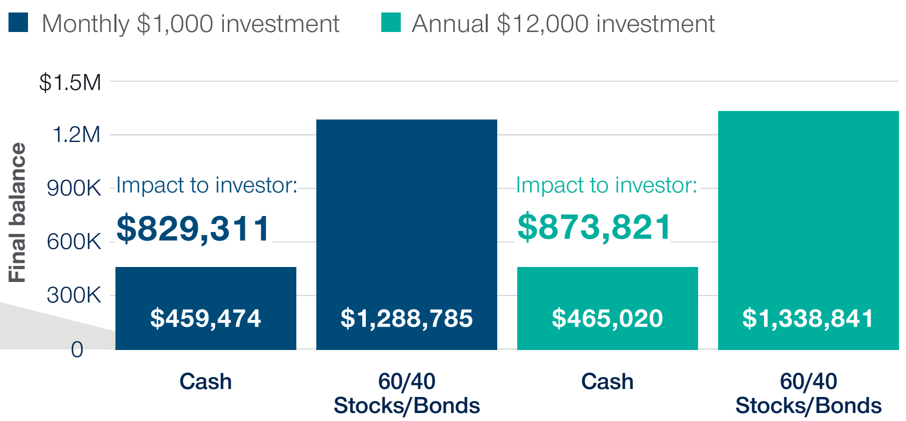
STEADY CONTRIBUTIONS TO A 60/40 PORTFOLIO—RATHER THAN CASH—PRODUCED A BIGGER BALANCE OVER THE SHORTER AND LONGER TERM

An investor using a systematic investment strategy who invested $12,000 in a 60/40 (stocks/bonds) portfolio at the start of every year, or $1,000 at the beginning of each month, for five years or 30 years, would have generated a larger nest egg than an investor who executed the same strategy but stashed the money in a cash account over those time periods.

Short-term opportunity cost (5 years ended June 30, 2023)



Long-term opportunity cost (30 years ended June 30, 2023)



Sources: T. Rowe Price, created with Zephyr StyleADVISOR; S&P; Bloomberg Index Services Ltd. See Additional Disclosures on page 2.

Past performance cannot guarantee future results. It is not possible to invest directly in an index. Chart is shown for illustrative purposes only. Stocks: S&P 500 Index, bonds: Bloomberg U.S. Aggregate Bond Index, and cash: Bloomberg 1–3 Month Treasury Bill Index. As of June 30, 2023.

Does systematic investing make sense for you?

Trying to time the market is virtually impossible. Building a diversified portfolio and staying the course is the best strategy to reach your goals.

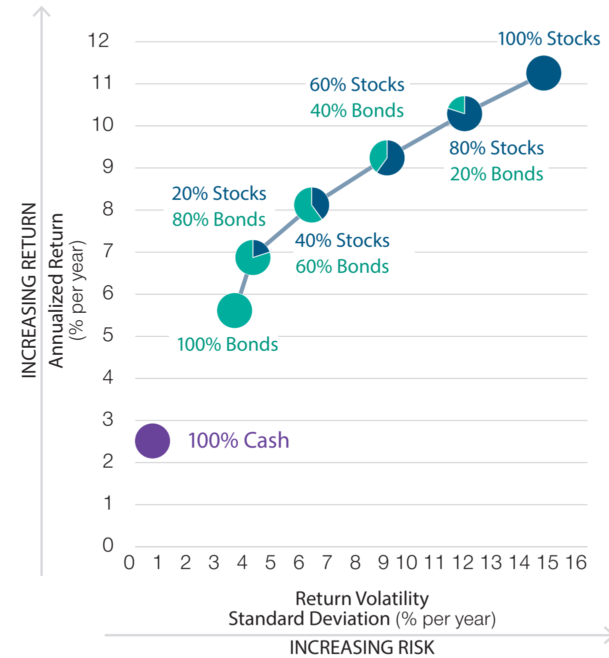
Over the long term, as the chart on the right shows, a portfolio that includes both stocks and bonds has posted higher returns than an all-bond or all-cash portfolio. A diversified portfolio is also less risky (as measured by volatility) than an all-stock portfolio. Bonds, thanks to lower return volatility compared with stocks and a focus on income generation, add ballast to a portfolio. In contrast, stocks have greater growth potential and historically have delivered larger returns than fixed income investments. To boost your chances of investment success, it's important to build a portfolio with an asset allocation that is a good match for your time horizon and risk tolerance.

Align your asset allocation with your risk tolerance and time horizon

We believe that the best way to build wealth, earn higher returns, and reach your financial goals is to stick to a long-term investment plan. When markets behave erratically, it can be tempting to flee to cash or make other poor investment decisions driven by emotions. Instead, ensure that your asset allocation is properly aligned with your long-term goals and time horizon. Continuing to invest a fixed amount of money at regular intervals, a strategy known as dollar cost averaging, can help keep your savings on track. This steady approach smooths out your average purchase price and helps you stay invested during periods of market volatility, which allows your portfolio to profit from the eventual market recovery.

ASSET ALLOCATION HAS A BIG IMPACT ON PERFORMANCE

30-Years Ended December 31, 2022



These hypothetical portfolios combine stocks and bonds to represent a range of potential risk/reward profiles. For each allocation model, historical data are shown to represent how the portfolios would have fared in the past. Figures include changes in principal value and reinvested dividends and assume the portfolios are rebalanced monthly. It is not possible to invest directly in an index. **Past performance cannot guarantee future results.**

Charts are shown for illustrative purposes only and do not represent the performance of any specific security or T. Rowe Price product.

Sources: T. Rowe Price, created with Zephyr StyleADVISOR; S&P; Bloomberg Index Ltd.; and FTSE. See Additional Disclosures. Stocks: S&P 500 Index; bonds: Bloomberg U.S. Aggregate Bond Index; cash: FTSE 3-Month U.S. Treasury Bill

Additional Disclosures:

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