FINANCIAL COMPASS

Latest must-have: a stash of cash for investment bargain hunting

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Always have cash on hand. That's the advice you'll hear from many investment industry pros. While cash sitting in an investment account can act as a drag on performance, it also allows investors to take advantage of market opportunities as they arise.

"This strategy has actually marked a big change over the last 15 years from when the main asset classes were bonds and stocks," says Diana Orlic, investment adviser with Orlic Harding Cooke Wealth Management Group with Richardson GMP in Burlington, Ont.

Fixed income and equities remain stalwarts of portfolio construction, but as markets become increasingly volatile, many advisers recommend strategies that allow for keeping cash on hand – sometimes upward of 30 per cent of the portfolio – to be able to buy "when there's blood in the streets," Ms. Orlic says.

Holding cash in a portfolio serves a variety of uses, from day-to-day cash needs for retirement to making calls on the market when conditions indicate the end of a bull run and the coming of a bear market, says Hardev Bains, portfolio manager and president of Lionridge Capital Management in Winnipeg.

In many instances, however, cash in a portfolio is the byproduct of a disciplined value investment strategy, says Mr. Bains. "My decisions to hold cash aren't directly driven by market conditions. They're indirectly driven by market conditions."

As a value investor, he generally selects stocks of good companies to buy and hold for the long term, but that does not mean hanging onto a particular investment interminably. "If the price gets too high and the market is willing to pay a premium for the stock beyond what I believe it's worth, I will opportunistically sell," he says.

"Once sold, my intention for the cash is to use it to invest in another idea. However, if there aren't any other good ideas to deploy the cash toward, I'll sit on it patiently."

This is a fairly common strategy among money managers, he says. If no buying opportunities arise over several weeks, cash can build up.

In the months running up to the stock market meltdown in 2008/2009, for example, some investors using this approach found it difficult to spend their cash in the markets because they deemed stock prices too high.

A similar scenario played out more recently when energy stocks were peaking last year, says Calgary-based financial adviser Patti Dolan, of Dolan Wealth Management, Raymond James. Many investors regret not taking some profit at the time. “There are all those people sitting around right now going, ‘Would’ve, could’ve, should’ve,’” she says.

Yet without a disciplined strategy in place to take profits systematically, investors find it difficult to sell when markets are marching upward. They are leery of the sell strategy because after they cash in, the discarded stocks may continue to rise in value, Ms. Dolan says.

“That’s a time when [the strategy] really has to be articulated to clients because they have a tendency to feel like they’re missing out on the upside.” But those who are patient are often rewarded when markets pull back, Ms. Orlic says.

In this respect a measured strategy to regularly take profits and set aside cash is a safety valve. Yes, investors can miss out if prices increase, but at the same time, losses in falling markets will be softened. And equally important, money is available to buy into the market after prices drop.

It’s a tried-and-true strategy often used by titans of the investment industry, including Warren Buffett. They go on buying sprees when other investors hit the panic button.

Yet markets do not have to be categorically falling, Mr. Bains says. The decision to buy is specific to each stock, according to its price and economic prospects.

“I don’t need the markets to fall for me to redeploy the cash,” Mr. Bains says. “They could stay where they are, but if the right four or five opportunities present themselves, I’ll happily use the cash to buy them.”

This has nothing to do with making a call on the direction of the markets, he adds. In fact, most professionals advise against speculating where the market is heading. It’s a fool’s game, Ms. Dolan says.

“You don’t have to go 100 per cent all in or out,” she says. “If investment professionals could predict when the bottom happens, we’d all be retired.”

Stick to the fundamentals – buying and holding good companies that pay dividends, she recommends. Revisit positions in the portfolio on a regular basis and do take profits to then pursue more attractively price opportunities.

While holding cash will drag down performance as markets rise, investors are often rewarded when markets fall and they have funds on hand when opportunity knocks, Ms. Orlic says. “Instead of feeling the fear, you’re feeling greedy because a down market is often a great time to use that cash to buy back into the equity market.”