Off With His Head? Why Cash Won't Always Be King

Cash's performance reigned supreme in 2022, but that's historically been the exception, not the rule.

While it's true that 2022 was a memorable year for investors, and not in a good way, it may also serve as a valuable reminder why we invest in equities and bonds in the first place.

In an unusual turn of events, cash was king in 2022—the strongest-performing asset class for the year (though outperformance is easy when all your competition is negative). With so much volatility in the markets, it may be tempting to chase that glimmer of outperformance and increase your allocation to cash, even if just to avoid further losses.

But that's where perspective can help. The last time cash outperformed, it solidly returned to last place the following year, which is much more typical than its outstanding performance so far: Over the long term, cash is usually the worst performer with an average of just 0.63% return in the last 15 years (**FIGURE 1**). Though different asset classes take turns in the lead, cash is almost always reliably underwhelming.

Key Points

- Cash outperformed in 2022, but in the last 15 years, it's only outperformed one other time and is usually one of the worst-performing asset classes.
- Instead of cash, fixed income and equities may make much more sense for long-term investors.
- Volatile markets have created some attractive entry points and future opportunities for those who stay invested—or reinvest—in equities and fixed income.

FIGURE 1

Performance Leadership Changes Frequently

Asset Class Returns % (2008-2022)

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Average
Treasuries 13.74	High Yield 58.21	High Yield 15.12	Municipals 10.70	Int'l Equities 17.32	US Equities 32.39	US Equities 13.69	Municipals 3.30	High Yield 17.13	Int'l Equities 25.03	Cash 1.82	US Equities 31.49	US Equities 18.40	US Equities 28.71	Cash 1.52	US Equities 10.67
MBS 8.34	Int'l Equities 31.78	US Equities 15.06	Treasuries 9.81	US Equities 16.00	Int'l Equities 22.78	Balanced Portfolio 9.83	MBS 1.51	US Equities 11.96	US Equities 21.83	Municipals 1.28	Int'l Equities 22.01	Balanced Portfolio 12.95	Balanced Portfolio 13.58	Municipals -8.53	High Yield 7.43
Bonds 5.24	US Equities 26.46	Balanced Portfolio 10.80	Corporates 8.15	High Yield 15.81	Balanced Portfolio 15.18	Municipals 9.05	US Equities 1.38	Balanced Portfolio 7.30	Balanced Portfolio 12.69	MBS 0.99	Balanced Portfolio 20.10	Corporates 9.89	Int'l Equities 11.26	High Yield -11.19	Balanced Portfolio 6.74
Cash 1.77	Corporates 18.68	Corporates 9.00	Bonds 7.84	Balanced Portfolio 10.11	High Yield 7.44	Corporates 7.46	Balanced Portfolio 0.97	Corporates 6.11	High Yield 7.50	Treasuries 0.86	Corporates 14.54	Treasuries 8.00	High Yield 5.28	MBS -11.81	Corporates 4.24
Municipals -2.47	Balanced Portfolio 16.20	Int'l Equities 7.75	MBS 6.23	Corporates 9.82	Cash 0.05	MBS 6.08	Treasuries 0.84	Bonds 2.65	Corporates 6.42	Bonds 0.01	High Yield 14.32	Int'l Equities 7.82	Municipals 1.52	Treasuries -12.46	Int'l Equities 3.82
Corporates -4.94	Municipals 12.91	Bonds 6.54	High Yield 4.98	Municipals 6.78	MBS -1.41	Bonds 5.97	Bonds 0.55	MBS 1.67	Municipals 5.45	High Yield -2.08	Bonds 8.72	Bonds 7.51	Cash 0.04	Bonds -13.01	Municipals 3.52
Balanced Portfolio -15.88	Bonds 5.93	Treasuries 5.87	Balanced Portfolio 4.98	Bonds 4.21	Corporates -1.53	Treasuries 5.05	Cash 0.03	Treasuries 1.04	Bonds 3.54	Balanced Portfolio -2.19	Municipals 7.54	High Yield 7.11	Corporates -1.04	Int'l Equities -14.45	Bonds 2.81
High Yield -26.16	MBS 5.89	MBS 5.37	US Equities 2.11	MBS 2.59	Bonds -2.02	High Yield 2.45	Corporates -0.68	Int'l Equities 1.00	MBS 2.47	Corporates -2.51	Treasuries 6.86	Municipals 5.21	MBS -1.04	Balanced Portfolio -15.56	MBS 2.47
US Equities -37.00	Cash 0.15	Municipals 2.38	Cash 0.07	Treasuries 1.99	Municipals -2.55	Cash 0.02	Int'l Equities -0.81	Cash 0.26	Treasuries 2.31	US Equities -4.38	MBS 6.35	MBS 3.87	Bonds -1.54	Corporates -15.76	Treasuries 2.35
Int'l Equities -43.38	Treasuries -3.57	Cash 0.13	Int'l Equities -12.14	Cash 0.08	Treasuries -2.75	Int'l Equities -4.90	High Yield -4.47	Municipals 0.25	Cash 0.82	Int'l Equities -13.79	Cash 2.21	Cash 0.54	Treasuries -2.32	US Equities -18.11	Cash 0.63

As of 12/31/22. **Past performance does not guarantee future results.** Indices are unmanaged and not available for direct investment. See last page for representative index definitions. For illustrative purposes only. Source: Morningstar, 4/23.

Any history scholar will tell you no throne room is complete without background scheming from courtiers. While cash was adjusting its newfound crown in 2022, the continued volatility in the financial markets was quietly setting the stage for potential long-term opportunities in other asset classes, such as equities and fixed income.

Focus on Fixed Income

For some of us, the dismal performance in 2022 made it easy to forget why we typically invest in certain asset classes (looking at you, fixed income). But sometimes lackluster performance is like hitting a reset button: after extended volatility and underperformance, investing after a downturn could be likened to hitting the clearance section.

While rising interest rates were one of the causes for recent underperformance, they've also set up two important conditions going forward. First, since bond prices fall when yields rise, today's prices are somewhat depressed, creating attractive entry points for investors.

Second, it means bond yields, which have been near zero for years, are now looking the most attractive they have in a decade (**FIGURE 2**). As the Federal Reserve (Fed) raised interest rates in its effort to combat inflation, yields also continued to rise. As of this writing, expectations for the peak federal funds rate were between 5-6%.[1]

FIGURE 2

Bonds Yields Are the Most Attractive They've Been in a Decade

Index	Yield to Worst (3/31/23)	Yield Percentile (Last 10 Years)*
Bloomberg US Aggregate Bond Index	4.40%	96th
Bloomberg US Treasury Index	3.83%	95th
Bloomberg Municipal Bond Index	3.25%	94th
Bloomberg US Corporate Index	5.17%	96th
Bloomberg US Corporate High Yield Total Return Index	8.52%	92nd

As of 3/31/22. **Past performance does not guarantee future results.** Yield to worst is the minimum yield that can be received on a bond assuming the issuer doesn't default on any of its payments. *For yield percentile, 100th is most attractive and 1st is least attractive. See last page for representative index definitions. Sources: Bloomberg and ICE BofA Indices.

An Eye on Equities

As is the case with fixed income, all the downward pressure in 2022 and volatility in 2023 may have done some favors for those who know where to look in equities, too. For example, many corporate valuations have been pushed down. Like bonds, this may provide investors an attractive entry point.

There are many things weighing on equities these days, from the war in Ukraine to inflation and the collapses of the Silicon Valley Bank and Signature Bank. But if the Fed succeeds in taming inflation in a meaningful way and avoids a recession in the process, it should help confidence return to the equity markets.

That, in turn, will help improve underlying fundamentals—stock earnings could resume a growth trajectory, margins would improve, and labor costs could slow.

[1] Economic Analysis & CME Group, as of 4/23.

Once some of the stresses are removed from equities, the recovery could kick in surprisingly strong. Even after some of the deepest market declines, equities have historically made solid recoveries—often double-digit gains within just six months of hitting a bottom (**FIGURE 3**).

It may still take months or years to break even from losses, but the advantage of staying invested is that you take part in the momentum of a rebound from day one.

FIGURE 3

After Significant Drawdowns, Equities Have Tended to Make Strong and Swift Recoveries

10 Worst Market Drawdowns Since the 1960s

Cause	Max Drawdown	# of Months To Hit Bottom	# of Months To Break Even	Returns (%) After Reaching Bottom		
				After 6 Months	After 1 Year	After 3 Years
Kennedy Slide/Flash Crash (1961–1962)	-27.97	6	14	20.45	32.66	16.65
Vietnam Worries (1968–1970)	-36.06	18	21	22.80	43.73	15.92
Nixon Shock (1973–1974)	-48.15	21	69	29.74	39.36	15.49
Rate Hikes to Fight Inflation (1980–1982)	-27.11	20	3	44.14	58.33	22.35
Black Monday (1987)	-33.51	3	20	19.26	22.78	13.69
Iraq Invaded Kuwait (1990)	-19.92	3	4	27.81	29.10	15.97
Asian Financial Crisis (1998)	-19.34	2	3	29.36	37.93	5.66
Dot-com Bubble Burst (2000–2002)	-49.15	31	56	11.49	33.73	15.47
Global Financial Crisis (2007–2009)	-56.78	17	49	52.75	68.57	26.54
COVID-19 Pandemic (2020)	-33.93	1	5	44.67	74.78	20.86
Average	**-35.19**	**12**	**24**	**30.25**	**44.10**	**16.86**

Past performance does not guarantee future results. Data shown is for the S&P 500 Price Index as of 3/31/23 and does not include the reinvestment of dividend payments. A drawdown measures a peak-to-trough decline in the market. Returns for less than one year are not annualized. Indices are unmanaged and not available for direct investment. Data Sources: Morningstar and Hartford Funds, 4/23.

6 MONTHS AFTER HITTING A LOW, STOCKS HAVE RETURNED 30% ON AVERAGE

Conclusion

All this said, there's no telling when cash will be dethroned. Inflation has proved tricky to tame, and it's unclear if the Fed will be able to engineer a gentle end to inflation without pushing the economy into recession. With the recent bank collapses, the possibility of tightening credit conditions may also add pressure to the economy. All this uncertainty is likely to continue to feed volatility for both equities and bonds.

But if nothing else, cash's brief reign may help investors step back and examine their portfolios. Cash can serve an important role in a portfolio, whether as a source of liquidity or as a cushion against volatility. But as a source of return, its outperformance vs. other assets classes is likely to be brief, slim, and probably not worth giving up long-term growth or income prospects that its peers have historically provided.

Working with a financial professional today can help set up a portfolio that's allocated for tomorrow's opportunities, whether it's in equities, bonds, or cash—or a combination of all three.

Talk to your financial professional to make sure your portfolio is properly allocated for your goals and risk tolerance.

Balanced Portfolio is represented by 50% S&P 500 Index/50% Bloomberg US Aggregate Bond Index. US Equities are represented by the S&P 500 Index. The **S&P 500 Index** is a market capitalization-weighted price index composed of 500 widely held common stocks. Bonds are represented by the Bloomberg US Aggregate Bond Index. The **Bloomberg US Aggregate Bond Index** is composed of securities that cover the US investment-grade fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. Cash is represented by the **Bloomberg US Treasury Bill 1-3 Month Index**, which is designed to measure the performance of public obligations of the US Treasury that have a remaining maturity of greater than or equal to 1 month and less than 3 months. Corporates are represented by the **Bloomberg US Corporate Index**, a market-weighted index of investment-grade corporate fixed-rate debt issues with maturities of one year or more. High Yield is represented by the **Bloomberg US Corporate High Yield Total Return Index,** an unmanaged broad-based market-value-weighted index that tracks the total-return performance of non-investment grade, fixed-rate, publicly placed, dollar-denominated and nonconvertible debt registered with the Securities and Exchange Commission. International equities are represented by the **MSCI World ex USA Index**, a free float-adjusted market-capitalization index that captures large- and mid-cap representation across developed-markets countries excluding the United States. MSCI performance is shown net of dividend withholding tax. Mortgage backed-securities (MBS) are represented by the **Bloomberg US MBS Index**, which tracks fixed-rate agency mortgage-backed passthrough securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). Municipal bonds are represented by the **Bloomberg Municipal Bond Index**, an unmanaged index that is considered representative of the broad market for investment-grade, tax-exempt bonds with a maturity of at least one year. Treasuries are represented by the **Bloomberg US Treasury Index**, an unmanaged index of prices of US Treasury bonds with maturities of one to 30 years.

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