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- Reinvesting cash can be one of the most difficult investment decisions facing investors.
- 'Waiting for a pullback' may not be a sound reinvestment strategy for portfolios with longer time horizons.
- Reinvesting cash requires a plan that extends beyond simple 'market timing'.

Reinvesting in a Rising Market is Like Merging into Traffic…It's Best to Start Now

Getting out of the market is easy…getting back in can be another matter entirely

Investors are regularly inundated with scary headlines and dour forecasts that provide ample reasons to get out of the stock market. Combine that with our natural 'fight or flight' instincts that kick-in when markets are volatile, and that it is not unusual to find oneself holding too much cash after a market bottom. Unfortunately, few that find themselves in this position know what to do or have a plan for reinvestment. This week's edition of the *Weekly View* is dedicated to the age-old question: 'What do I do when I have too much cash on the sidelines?'

FIRST, SWALLOW YOUR PRIDE

There can be many obstacles to reinvestment, but often one of the biggest is that it requires an admission of being wrong. No one likes to admit that that they bought or sold for the wrong reasons, or that their hopes or worries were misguided. Many would prefer to stick with their decisions, even when the preponderance of evidence suggests otherwise. We believe investors need to get comfortable with the notion of 'being wrong' and moving on. If you sold stocks for the wrong reason don't beat yourself up over it. Rest assured, you are in good company with many of the investment greats who have made similar mistakes. However, it is important not to compound a bad decision by failing to recognize when the facts change. In our view, 'being wrong' happens to all investors from time to time, but 'staying wrong' often makes the difference between investment success and failure.

SECOND, DETERMINE WHETHER THE CONDITIONS HAVE CHANGED

A recent example: if you sold stocks in 2018 because you were worried about rising interest rates or the lack of resolution to the US/China trade war – two of the three crucial 'R's from our *2019 Outlook* - it is important to recognize that the conditions have likely improved over the past two months. From an interest rate perspective, the Federal Reserve appears to be on 'pause' since its last rate hike in December, and recently noted that the balance sheet normalization process, otherwise known as quantitative tightening, was nearing an end. US/China trade relationships appear to have also markedly improved since year-end. Over the past two months, both nations have completed several bi-lateral meetings and are rumored to be finalizing six memorandums of understanding (MOU's) to govern future trade interactions.

THIRD, DETERMINE IF CASH UNDERMINES LONG-TERM GOALS

In today's low interest rate environment, large cash holdings could be an obstacle to funding future obligations, like college or retirement. When cash is accumulating a reasonable level of interest in the bank or in a brokerage account, the long-term costs of sitting out can be less punitive. However, with short-term rates only slightly above inflation, cash on the sidelines provides minimal real growth as it sits idle. If one needs their portfolio to grow, less risk-taking today could lead to greater risk taking tomorrow since one might be forced to own higher-risk securities to 'play catch-up'.

FOURTH, DON'T BE 'PENNY-WISE AND POUND-FOOLISH'

In our view, the longer an investor's time horizon, the less important market entry points are. We believe the adage that successful investing is about 'time in the market,' NOT 'timing the market' holds merit for long-term investors for two reasons. First, over long-time horizons, the US stock market has generally recovered its losses, as it has this year with the significant snapback from December 2018's weakness. Second, long-term investors benefit from what Albert Einstein called "one of the most powerful forces in the universe": compound interest. Compound interest allows a $100 investment growing at 10% annually to return more than 6 times an investor's initial money after 20 years. We believe that investors who jump in and out of the market tend to be un-invested or underinvested more frequently and thus less likely to experience the full benefits of market recoveries or compound growth.

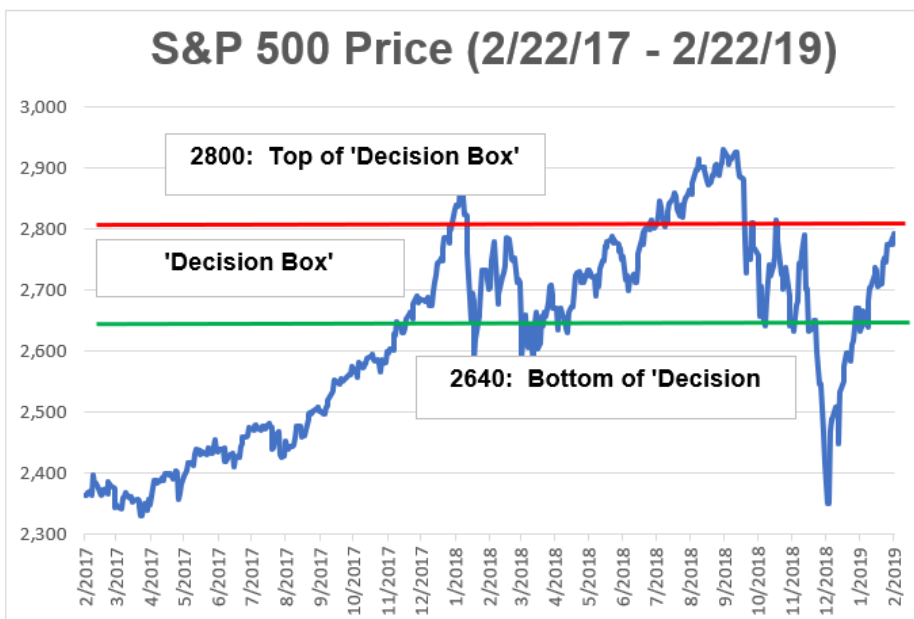
FIFTH, DEVELOP AND EXECUTE ON A PLAN

There are many reinvestment strategies that have shown historical efficacy. One that we would caution investors against is 'market-timing'. Market-timing is the practice of trying to predict market bottoms and tops and moving from stocks to cash accordingly. Instead, we believe that entry and exit strategies should be consistent with the investor's goals and objectives and not solely dependent on one's ability to accurately forecast market movements over short periods of time. The goal of a long-term investor should be to get reinvested quickly, while minimizing the risk of putting all their cash back to work prior to a significant market pullback.

A REINVESTMENT PLAN: MERGING INTO TRAFFIC

Reinvesting into a market that is rising can be similar to an activity that we are all familiar with: Merging into moving traffic. For most of us, the action of merging requires little thought because it has become second nature. However, if we take a minute to examine it, we can identify three important steps that can be applied to the reinvestment process.

- ***Start Immediately:*** When you are merging onto the Interstate you start the process immediately by getting up to speed. You don't stop on the entrance ramp to wait for an opening because if you did you would lose all your momentum (and your nerve). Likewise, when reinvesting cash, we believe investors should also start the process immediately, given current market conditions. We do not believe that the secular bull market that began in 2009 is over and therefore do not recommend waiting for a pullback before putting some excess cash to work. In our view, recent market strength suggests that it is more likely we retest the September 2018 highs (around 2940) than retest the December 2018 lows (2350). Additionally, we believe that its equally likely that the market receives positive economic news over the next 12 months as it does negative. While we are concerned about slowing earnings growth and the potential for an economic recession; we also recognize that valuations are not excessive, the Fed is now on the investors side and we think President Trump will be looking for opportunities to positively impact the economy prior to his re-election campaign in 2020.



Source: Factset Data Systems. Shown for illustrative purposes and not intended as an investment recommendation. Past performance is no guarantee of future results.

- ***Reinvest some <u>Opportunistically</u>:*** When merging onto the highway, gaps in the traffic will appear as you get up to speed. These gaps provide opportunities to merge more quickly. From a reinvestment perspective, investors can designate a portion of their cash to take advantage of opportunities that may arise as a result of market volatility. In fact, after a nearly 20% bounce from the December 2018 lows, it would be surprising if we did not experience some pullback or digestion period in coming months. We believe that a pullback will be confined to the 'decision box' shown in the right chart. In our view an 'opportunistic' reinvestment window would open if the market declined about 4-6%, which would coincide with the bottom of the 'decision box' or near 2640 on the S&P 500.
- ***Complete <u>Gradually</u>:*** Gradually the merger lane comes to an end, and the driver must complete the merge. Reinvestment windows also come to an end because investors risk missing out on the 'power of compound interest' if they fail to reinvest in a timely manner. To offset the risk of bad timing, investors can use a dollar-cost- average approach to gradually reinvest on a series of dates over a defined time period. Three to six months is probably the appropriate time period for a long-term investor to reinvest their cash, in our view. Starting today a three to six- month window would encapsulate periods of seasonal market strength (November to April) and periods of seasonal market weakness (May to October), in our view.

PORTFOLIO IMPLICATIONS:

RiverFront's balanced portfolios are currently 'fully-invested', which means the portfolio's equity weightings exceed their composite benchmarks. Our longer-horizon portfolios have only 'frictional' levels of cash (around 2%), while our shorter-horizon portfolios have roughly 5% cash that may be deployed opportunistically into equities or fixed income.

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In a rising interest rate environment, the value of fixed-income securities generally declines.

It is not possible to invest directly in an index.

Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.

Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.

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