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Is cash still trash?

A common investment mantra amongst global investors in recent years has been "cash is trash". With interest rates so low, they have been forced to seek yield in more risky assets, driving the prices of most other assets up in unison. Time will tell as to what extent this reallocation to more risky assets will prove to have been sensible, but the first few months of 2018 has at the very least started to sow a few seeds of doubt amongst complacent investors.

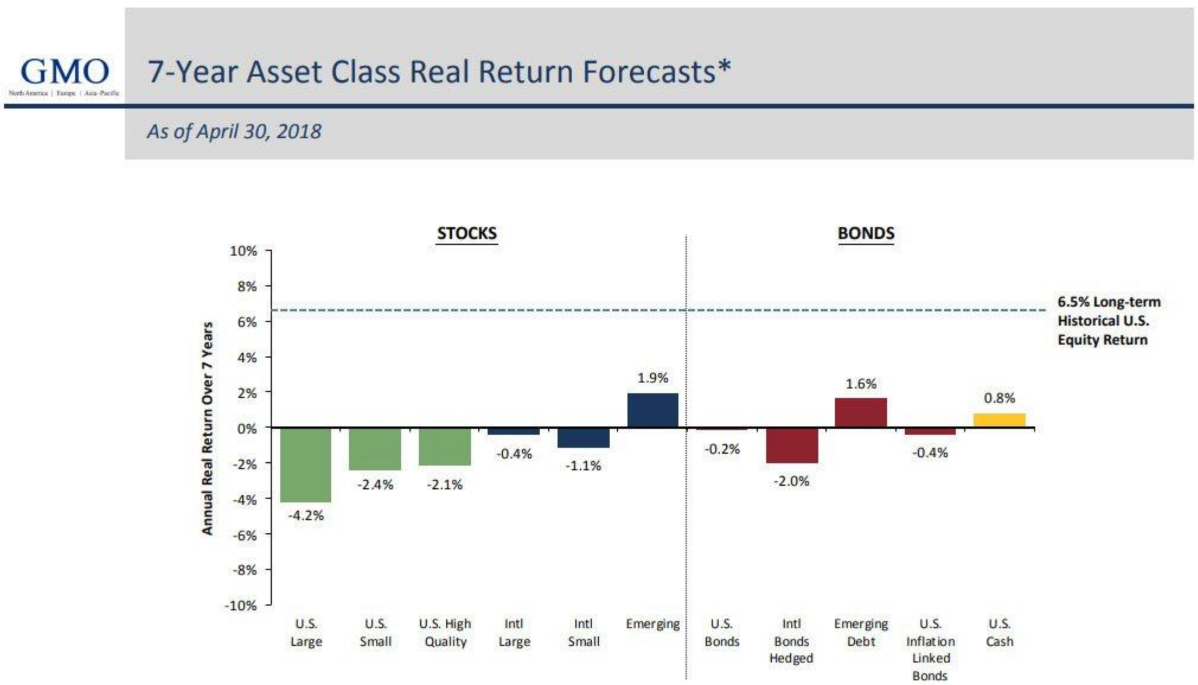
The chart below shows the closing of the gap between short-term rates and equity dividend yields in the USA and captures this changing environment very well.

This move in rates has been particularly painful on so called bond proxies, or defensive equities that were deemed to have bond-like characteristics. Consumer staple shares like Coca Cola, Procter and Gamble and British American Tobacco have all had a very rough 2018. The low rate environment has seen many investment strategies migrating towards merely buying good companies, regardless of price. We also like to buy good companies, but only when they are available at a good price.

Having had no exposure to this expensive area of the market has benefitted our global portfolios in recent months, but over the past few years our large cash weightings and portfolio hedges have been a headwind. This, together with a lack of exposure to large growth stocks, has been the main reason our global portfolios have not kept up with strongly rising global markets over this period, even though they have produced very solid absolute returns. This short-term underperformance does not keep us awake at night, given the significantly lower level of risk at which we have achieved our returns.

Looking forward, we remain excited about the opportunity to add value for our global accounts. We continue to find good opportunities at a stock level and would be surprised if the massive flows into passive and growth strategies will continue unabated. We suspect that these seemingly low risk strategies will be tested at some stage, rewarding those that are prepared to invest independently of the herd.

The recently published return forecasts by GMO are inciteful. If their expectations are anywhere near correct, and they have a pretty good long-term track record, the outlook for passive strategies is far from exciting.



Cash may well have been trash in recent years, but we think its worst days are potentially behind it. We remain of the view that it has value in an environment where most assets are expensive and an enormous amount of good news has been priced in. This, together with an idiosyncratic portfolio of inexpensive shares that are not widely held by passive and short-term focused investors, allows us to sleep very well at night as we comb the globe for new investment ideas.
