

Cash: Now What?

A few years ago, when interest rates were at historic lows, many investors ventured away from cash holdings in search of higher yields. Certificates of deposit (CDs) and money market funds were barely keeping pace with inflation. But with interest rates climbing steadily over the past two years, now may be a good time to rethink your cash position.

Why Interest Rates Matter

Rising interest rates can have an adverse effect on some of the investments in your portfolio. For example, bonds typically lose value when interest rates rise. That's because new bonds sold today may offer higher yields than the bonds you purchased last year.

The stock market may also react negatively to interest-rate increases. When companies have to pay more to borrow money, corporate earnings tend to suffer. This can lead equity investors to exercise added caution.

Interest-rate hikes have the opposite effect on cash investments. When rates go up, yields on money market funds and CDs generally rise in sync. CDs typically offer better rates than money market funds, but they lock up your money for a set number of months or years, and they impose a penalty for early withdrawals. That's something to keep in mind if you expect rates to continue rising.

Money market funds are neither insured nor guaranteed by the FDIC or any other government agency. Although a money market fund attempts to maintain a stable \$1 share price, you can lose money by investing in a fund. Ask your financial professional for a prospectus, which contains information you should read about the fund's investment objectives, risks, and expenses. The FDIC insures bank CDs, which generally provide a fixed rate of return.

On the Rise?

Yields on money market funds have fluctuated dramatically over the last five years. At the end of 2005, they were approaching four-year highs.



Source: Thomson Financial, 2006, for the period 12/31/2000 to 12/31/2005. Money market funds are represented by the 30-Day Money Market Index. The performance of an unmanaged index is not indicative of the performance of any particular investment. Individuals cannot invest directly in an index. Past performance is never a guarantee of future results. Money market funds are neither insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although a money market fund attempts to maintain a stable \$1 share price, you can lose money by investing in a fund.

Don't Spend It All in One Place

Of course, a portfolio that is too heavily weighted in cash may not be the best scenario either. Over time, both stocks and bonds have historically outperformed cash equivalents, and they generally experience greater volatility.¹ A well-balanced portfolio might diversify your investments over many different asset types, allowing you to manage risk and weather market volatility. Diversification does not guarantee against loss; it is a method used to help manage investment risk.

Since the tech boom of the late 1990s, interest-rate fluctuations have kept investors on their toes. Today's interest rates may prompt some individuals to give cash a greater role in their portfolios.

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1) Thomson Financial, 2006, for the period 12/31/1985 to 12/31/2005. Stocks are represented by the S&P 500 Composite (total return), which is considered representative of the U.S. stock market. Bonds are represented by the Citigroup Corporate Bond Composite Index, which is considered representative of the U.S. corporate bond market. The performance of an unmanaged index is not indicative of the performance of any particular investment. Individuals cannot invest directly in an index. Past performance is never a guarantee of future results.