

## The Folly of Leaving Cash in the Bank

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- Over any extended timeframe, equities have provided substantially better returns than cash deposits.
- Timing the peaks and troughs in markets are impossible but it doesn't really matter if your timeframe is long enough.
- The purchasing power and value in real terms (after inflation) of cash left in the bank is being ravaged by the wide gap between the rate of inflation and interest rates.

Amidst the uncertainties of the horrors taking place in Ukraine and the economic outlook as companies and consumers grapple with the eruption of inflation and rising interest rates, we certainly understand why it might seem safer to many investors to leave their money in the bank for now.

The right thing to do, however, is exactly the opposite. Investors are invariably most fearful and bearish when prices are falling and are always most exuberant and bullish when prices are soaring. It is simply human nature. The basic premise of successful investing is to 'Buy Low and Sell High'. The best times to invest, therefore, are when everyone is fearful, and prices are falling. Conversely, the best time to take risks off the table is when prices have risen, and everyone is most bullish. Of course, such discipline requires a strong nerve. No investor, no matter how skilled, experienced, or celebrated, can accurately predict the exact troughs and peaks in markets. An investor might be lucky once but to do it consistently is impossible. Therefore, it is more than likely that an investor buying into a falling market will at first sustain some losses that will test their nerve. Moreover, an investor taking profits will often see prices rise further after they have sold, and this will grate.

Provided the time horizon is long enough, however, history shows that the timing of new investment is relatively unimportant in the context of long-term returns. Only if the money to be invested is needed in a few years, say to fund retirement, is there a significant risk of stark financial consequences because of investing at a market peak and having to sell at a market trough.

The tables below compare the returns of investing in the UK stock market (as represented by the FTSE All-Share Index) with dividends re-invested and the returns of investing in cash deposits with interest re-invested.



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**From the beginning of the century (2000) to 31st March 2022 (i.e., just over 21 years)**

	<b>Initial Investment on 31.12.1999 (£)</b>	<b>Value on 31.03.2022 (£)</b>	<b>Total Return (%)</b>	<b>Annualised Return (% p.a.)</b>
UK Equities	100,000	278,230	178.2	4.7
Cash	100,000	167,660	67.7	2.4

*Source: FE fundinfo. Data as at 31<sup>st</sup> March 2022. Past performance is not a guide to future returns.*

**From the beginning of 2010 to 31st March 2022 (i.e., just over 11 years)**

	<b>Initial Investment on 31.12.2009 (£)</b>	<b>Value on 31.03.2022 (£)</b>	<b>Total Return (%)</b>	<b>Annualised Return (% p.a.)</b>
UK Equities	100,000	234,040	134.0	7.2
Cash	100,000	106,810	6.81	0.5

*Source: FE fundinfo. Data as at 31<sup>st</sup> March 2022. Past performance is not a guide to future returns.*

The returns in the two tables above are very different because the longer, first period includes the two 'full-on' bear markets that investors have endured so far this century. Following the 'Dotcom Bust' in 2000, UK equities fell by 48% between September 2000 and March 2003. Similarly, UK equities fell by 46% between October 2007 and March 2009 in the Financial Crisis. Despite these two very big declines, however, equities have still outperformed cash deposits by more than 100% since the beginning of the century. It should also be remembered that cash deposits provided returns of around 5% per annum, between 2000 and 2008. Both periods, of course, include the 35% fall in UK equities between January and March 2000 as the Covid pandemic took hold.

But what if the investment in UK equities had been made at precisely the worst time and at a market peak, for example on the eve of the Financial Crisis at the end of October 2007. In the following seventeen months, that investor would have suffered a loss of 46% and would have rued not leaving their money in the bank. However, by January 2013 the value of that investment in UK equities had not only recovered completely but had also overtaken what would have been earned in cash deposits. And to the end of March 2022, that same investment made at the peak of the market in 2007 would have delivered a gain of 104% whereas cash in the bank has provided a cumulative return of just 16%.

Inflation is the other reason why it is a mistake to leave money in the bank. Given that most savings and pensions are for use in the future, the minimum return an investor should be seeking is the rate of inflation, such that the purchasing power of those savings or pensions is maintained. Over much of the last three decades, the rate of inflation in the UK has remained very low so the erosion of purchasing power has been modest and possibly acceptable for an investor unwilling to take any risk. It is different now. The latest rate of inflation in the UK (for the year to the end of March 2022) as measured by the Consumer



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Prices Index is 7.0%. The old Retail Prices Index, which many would argue is a better representation of the cost of living, is 9.0%. Both figures are expected to rise further in the months ahead and, although it is probable that they will then decline in 2023, it seems unlikely that the rate of inflation will fall back to anywhere near 2% anytime soon.

Interest rates have risen in the UK over the last few months and are likely to rise further in the months ahead. However, interest rates in the UK are currently more than 6% below the rate of inflation and this gap may increase in the months ahead. The purchasing power and value of money left in the bank are therefore falling by more than 6% per annum in 'real' (i.e., after inflation) terms. This is substantial.

Investing in equities involves risk to capital but, according to The Financial Times, the dividend yield on the UK equity market is 3.2%. It may not be to everyone's taste in today's climate-conscious world but shares in BP provide a dividend yield of more than 4%. That's a big offset against the ravages of inflation.

Unless the time horizon is short, it makes little sense to leave money in the bank earning a paltry and far-below-inflation yield.

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