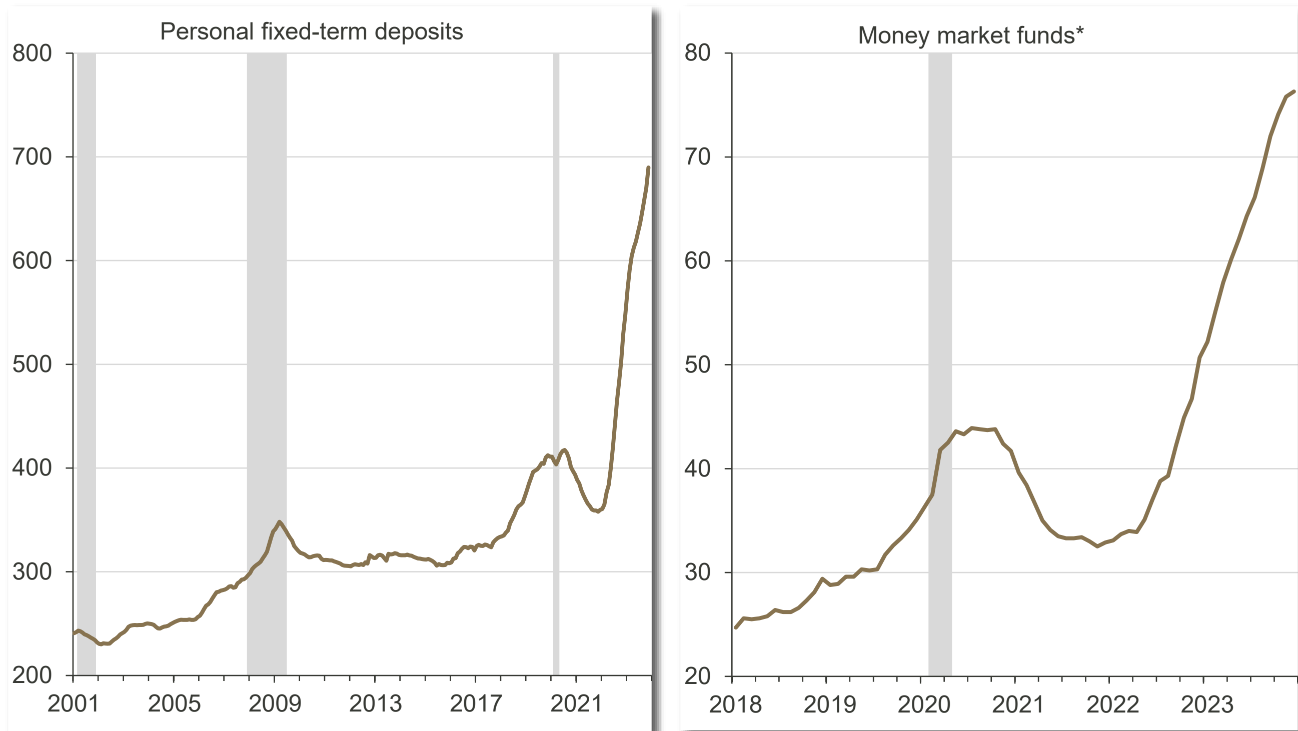
Cashing out

Money market funds have experienced a surge of inflows in recent years. These short-term investment vehicles have recorded more net sales in Canadian retail markets than all other asset classes combined over the last two years. This has resulted in net assets under management more than doubling since the end of 2021 to C$76 billion. Personal fixed-term deposits at banks, including guaranteed investment certificates (GIC), have almost doubled as well over that same period — an increase of a whopping C$330 billion to almost C$700 billion.

A cache of cash

(Personal fixed-term deposits and money market fund* net assets, Canada; billions of Canadian dollars)



Domestic mutual funds & exchange-traded funds; shaded regions represent periods of US recession; source: Guardian Capital based on data from the Investment Funds Institute of Canada and the Bank of Canada to December 2023

Heightened uncertainty and volatility in the marketplace have increased the appeal of a safe place to stash cash. A larger driver of this near-unprecedented flood of money into cash & equivalents, however, has been the sharp increase in market interest rates that actually makes the asset class compelling from a return perspective for the first time in many investors' adult lives.

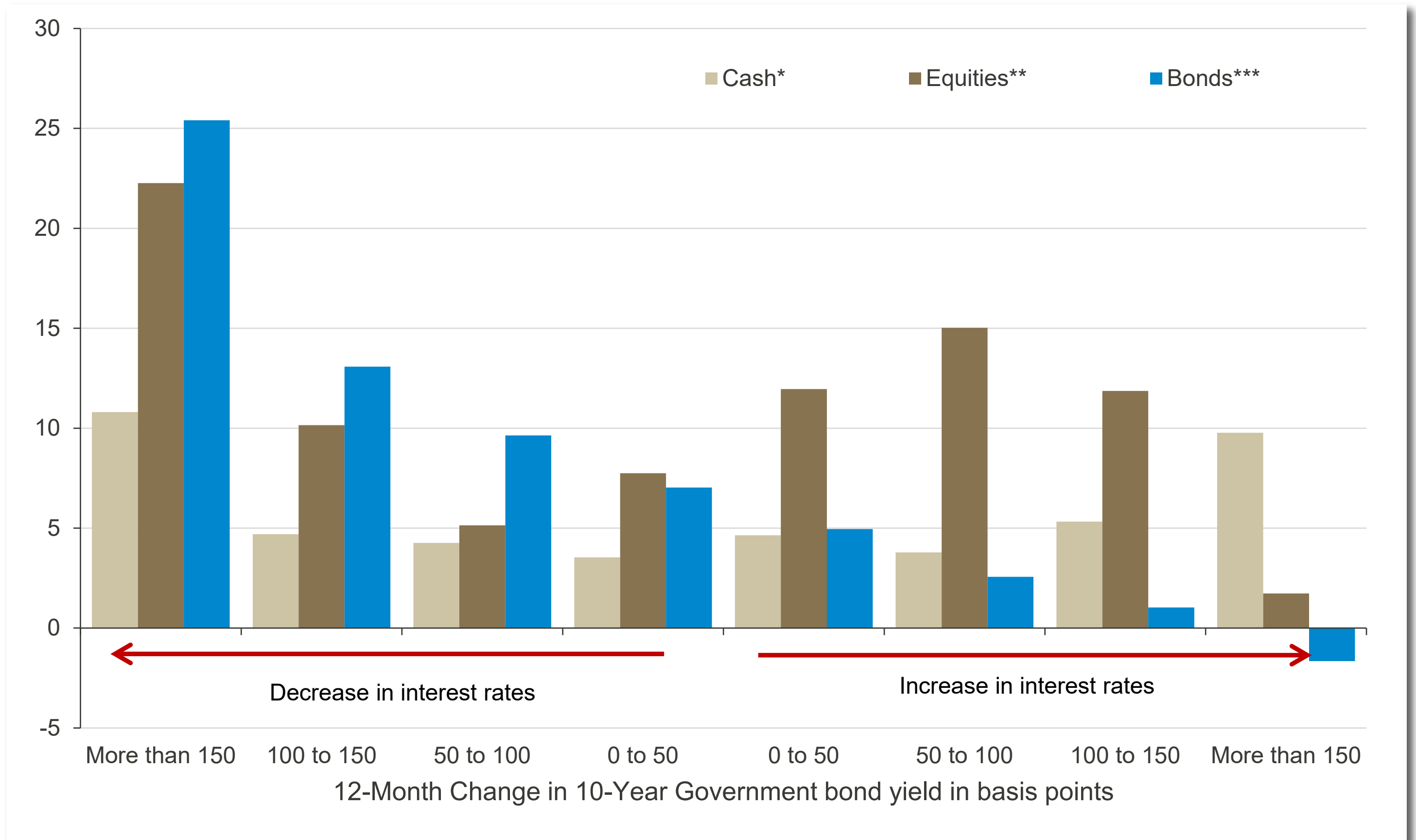
Indeed, the 4.7% total return on cash (as proxied by the FTSE Canada 91-Day Treasury Bill Index) last year represented the asset class' best calendar performance in 22-years — and while the outsized rally across financial markets in the final two months of 2023 resulted in it lagging the returns on domestic equities (S&P/TSX Composite Index +11.8% total return) and bonds (FTSE Canada Universe Bond Index +6.7%), its cumulative

6.6% return over the last two years outpaced the other asset classes (S&P/TSX +5.2% total return over the same period; -5.8% for the broad Canadian bond index) while having to endure effectively none of their volatility.

Interestingly, this cash outperformance as market interest rates surged (the 10-year Government of Canada note yield increased by 168 basis points over the two-years ended December 31, 2023) is not a historical anomaly. It is actually the norm in these market conditions as data covering more than four decades show that cash is the top-performing asset class on average when rates rise by at least 150 basis points (a top 10 percentile move).

On a sliding scale

(Asset class 12-month average total return by change in rates; percent) class on average when rates rise by at least 150 basis points (a top 10 percentile move).



**Cash=FTSE Canada 91-Day T-Bill Index; **Stocks=S&P/TSX Composite Index; ***Bond=FTSE Canada Universe Bond Index; source: Guardian Capital based on data from Bloomberg and PC Bond from January 1979 to December 2023.*

It is, however, only in these extreme market scenarios where cash has historically been the best option for investors. In periods of more modest increases in interest rates — which typically coincide with an upswing in the market cycle in which growth and inflation are rising, increasing the anticipation of central bank rate increases — equities are the top performer on average. The same holds true when rates stay roughly flat. Periods of

declining rates — which typically coincide with more down economic outlooks that presage central banks easing policy — see bonds outperform.

Looking to the months ahead, central banks are broadly expected to begin cutting rates as progress on getting inflation back within the realm of "normal" allows policymakers to return to a more "neutral" setting as they try to navigate a "soft landing." While the timing and magnitude of cuts is going to a matter for debate, there is an overwhelming consensus on the direction (barring some sort of inflationary shock that spurs central banks into further action).

The prospect of lower interest rates would mean lower returns and increased reinvestment risk, which make the case for cash less compelling relative to other asset classes that have historically fared better in more benign interest rate environments — and any redeployment of that cache of cash (which is equivalent to roughly 25% of the total Canadian equity market capitalization) would certainly provide a lift to other asset classes.

While the outlook remains uncertain, it would appear investors who find themselves sitting on an abundance of cash could improve their longer-term financial health by adding investments that fare well in more "normal" interest rate environments to portfolios — namely, assets such as equities and longer-dated bonds that derive more of their value from their future prospective cash flows rather than current payments as their price goes up as interest rates go down, all else the same.

It is a pivotal time to consider having a discussion with your financial advisor about your investments.

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PERSPECTIVES
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