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**William A. Harris, CFA**  
**Chief Investment Officer**

## Cash, Volatility, and Opportunity

*A ship in port is safe, but that's not what ships are built for.*

Grace Murray Hopper

Recently I was talking with Wake Mack, our Senior VP of Business Development, about renewed volatility in the markets and how it might make cash-rich would-be investors all the more inclined to “sit on their hands.” Wake put it to me directly: “Well, Bill, it’s scary out there. How would you deploy an all-cash account today without making it scarier?”

Here’s my answer.

For each client we target a strategic asset allocation (e.g. xx% stocks + yy% bonds + zz% cash) which we expect will best serve their goals and risk parameters over the long run. The only scenario in which we would immediately invest “lump sum” to fulfill that allocation, however, would be if all the assets we’d like to own were simultaneously cheap. While the imagination might be able to conjure such a scenario, reality is unlikely to do so – which means we expect to deploy cash only gradually, at a pace which is determined foremost by market opportunity rather than by the calendar.

So does this mean that in an environment like today’s, when macroeconomic factors are looking dicey and Mr. Market is getting jumpy, we prefer cash? No. Just as the world can scarcely grace us with universally cheap assets, neither does it curse us with universally overpriced assets – and least of all when the volatility roller coaster gets

roaring again, accelerating the pace at which the prices of even good assets shake loose from their intrinsic value, giving rise to opportunity.

A big liquidity hoard can be comforting, and we don’t like to trade liquidity for risk assets unless the price is right. That said, at the moments when cash is *most* comforting (i.e. when everything else seems to be at its worst), it’s also at its most dangerous *from a long-term perspective*. To get the long run excess returns we expect from risky assets like stocks, we have to own them at their cheapest; markets usually make the bulk of their cyclical gains in very short periods soon after they bottom, and the penalty for non-participation in those early rallies is middling returns at best.

Unless an investor is either clairvoyant (we are not) or extremely lucky (we do not speculate that randomness will favor us), he will not know a bottom when it arrives. And when it does arrive, even if he thinks he recognizes it (and remember: he won’t know for sure in the moment), he may nonetheless find himself unwilling to surrender liquidity when it’s most prized and despair of other assets is running deepest. And even if he recognizes the bottom AND possesses the inverse emotionality necessary to act on it, he also needs, practically speaking, a sound plan in place that’s ready to execute.

Sitting on your hands is the right thing to do sometimes; but it is not a strategy.

In other words, for portfolios to do what they should – for them to carry you where you want to go, or to deliver their precious cargo (cash flows, at some point) – they have to set out on the big water and start steering across the waves.

*William A. Harris, CFA*