

“Cash is trash” – Explaining cash as an asset class

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At the recent World Economic Forum in Davos, Ray Dalio, manager at the largest hedge fund in the world, Bridgewater said it. He [said](#):

“CASH IS TRASH”

Many might not understand what he means as most of us, especially those a little bit older, were taught to save our money as cash is something valuable. That isn't the case anymore and hasn't ever been the case. Therefore, Ray Dalio didn't suddenly invent hot water, he is just telling a historical truth.

Let's put things into perspective by:

- Defining cash as an asset class
- Explaining why cash is definitely trash over the long-term
- Explaining how one can benefit from cash
- What should you do scenarios – cash or expensive stocks or???
- Discussing the skin in the game part – my cash

What is cash?

The definition of cash depends on whether you look at it from an economic or financial perspective. In economics, cash is the money you have in your pocket while in finance cash is current assets comprising currency or currency equivalents that can be accessed immediately or near-immediately. Thus, cash is something short term and usually liquid.

Also, cash is usually connected to a currency and a currency is something that offers store of wealth and is a medium of exchange. It offers that at least in the short term where the length of the safety period depends on inflation. Due to inflation, it is inevitable that cash loses its value over time and therefore the saying 'cash is trash'.

Cash is trash

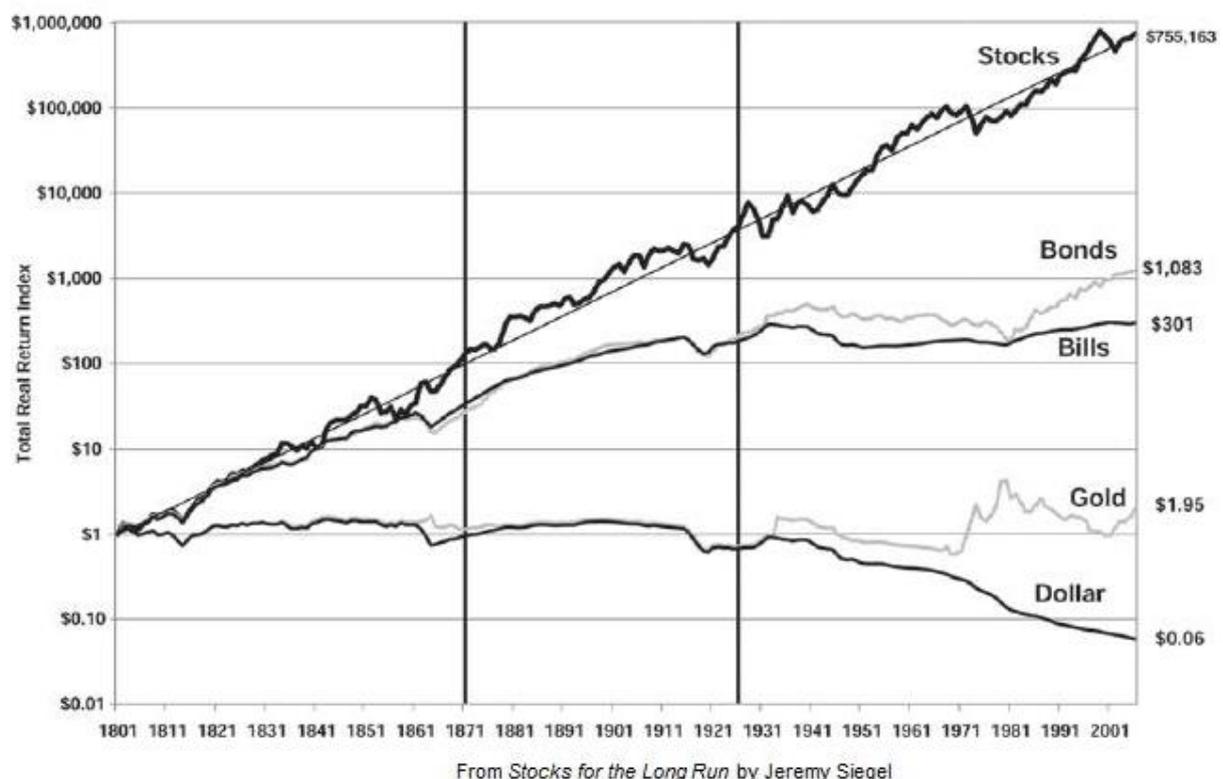
The 'cash is trash' saying is exceptionally meaningful today in a world of loose monetary policies and extreme government and corporate debt. Monetary policy and debt are the two reasons why Ray Dalio states that one should avoid having cash and should be globally diversified (more about that in a moment).

Why is cash trash?

To explain why cash is trash we can simply take a long-term historical perspective. If we go back to 1802 and look at the chart from Jeremy Siegel in [Stocks for the Long Run](#) showing returns on asset classes over two centuries, it quickly rests the case and confirms the fact that cash is trash.

FIGURE 1-4

Total Real Return Indexes, 1802 through December 2006



One dollar held from 1801 till today would be worth just 6 cents from a purchasing power perspective while the same dollar invested in stocks would be worth about \$1.5 million. The chart shows \$755k but it was made in 2006 and stocks more than doubled since. Gold, T-bills and bonds do a little bit better than cash, but not that much better and can be considered equal to cash from an investing perspective.

There are another two things to note from the above chart. The first is that stocks are much more volatile than any other class – just something to keep in mind when investing.

The second thing is that cash actually started rapidly losing its real value only after the 1930s and definitely since the 1971 Nixon shock.

The 'Nixon shock' was a series of economic measures undertaken by United States President Richard Nixon in 1971, in response to increasing inflation, the most significant of which were wage and price freezes, surcharges on imports, and the unilateral cancellation of the direct international convertibility of the United States dollar to gold.

The United States dollar was exchangeable for gold where one ounce of gold was worth \$35. The same ounce of gold now is worth \$1,556. Gold is gold, so nothing changed there, while what changed is the real value of the dollar.



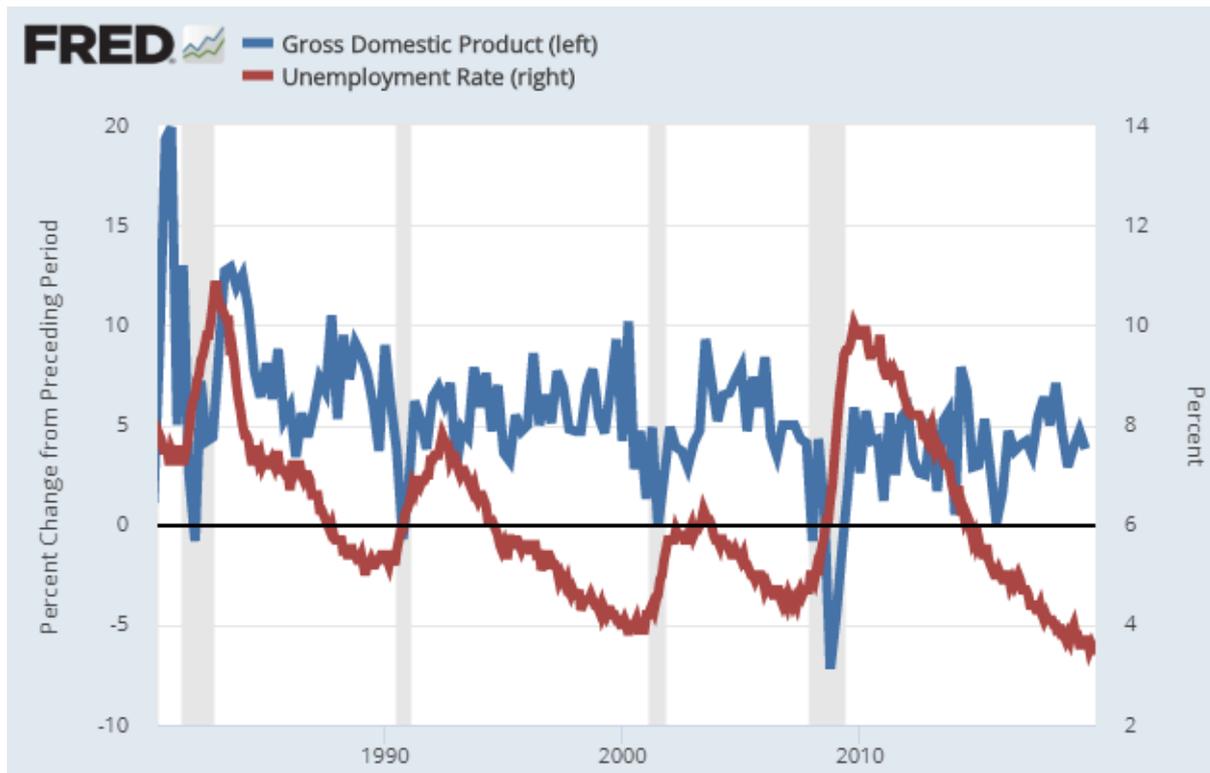
Gold price in cash USD – Source: [FRED Gold Price](#)

As from 1971 the dollar wasn't backed by gold anymore, it became a FIAT currency. A FIAT currency is a currency that is just backed by the government and the governments are usually very flexible when it comes to backing it.

Temporary perspective on cash is trash

Apart from the historical perspective on cash is trash, the current flexibility governments across the world exercise when it comes to their currencies is the main risk for cash and the reason why Ray Dalio is suggesting cash is trash.

The US economy is doing fine, has been doing fine for the last 10 years as it is enjoying the longest economic expansion in history. At the same time, unemployment is at historical lows.

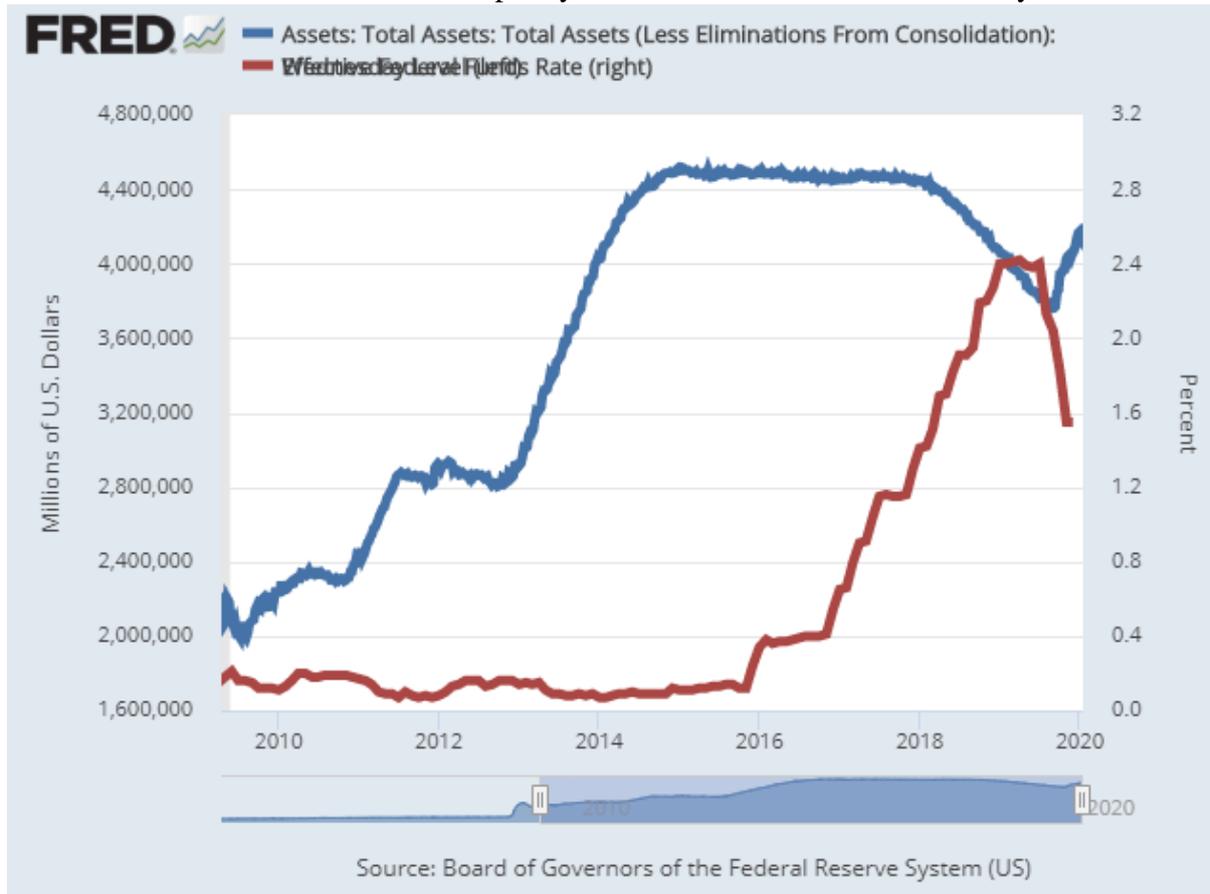


US annual change in GDP and the unemployment rate – Source: [FRED](#)

With such economic numbers, you might think that the FED and the government would have tight monetary and economic policies in order to save some dry powder for when an inevitable recession arrives.

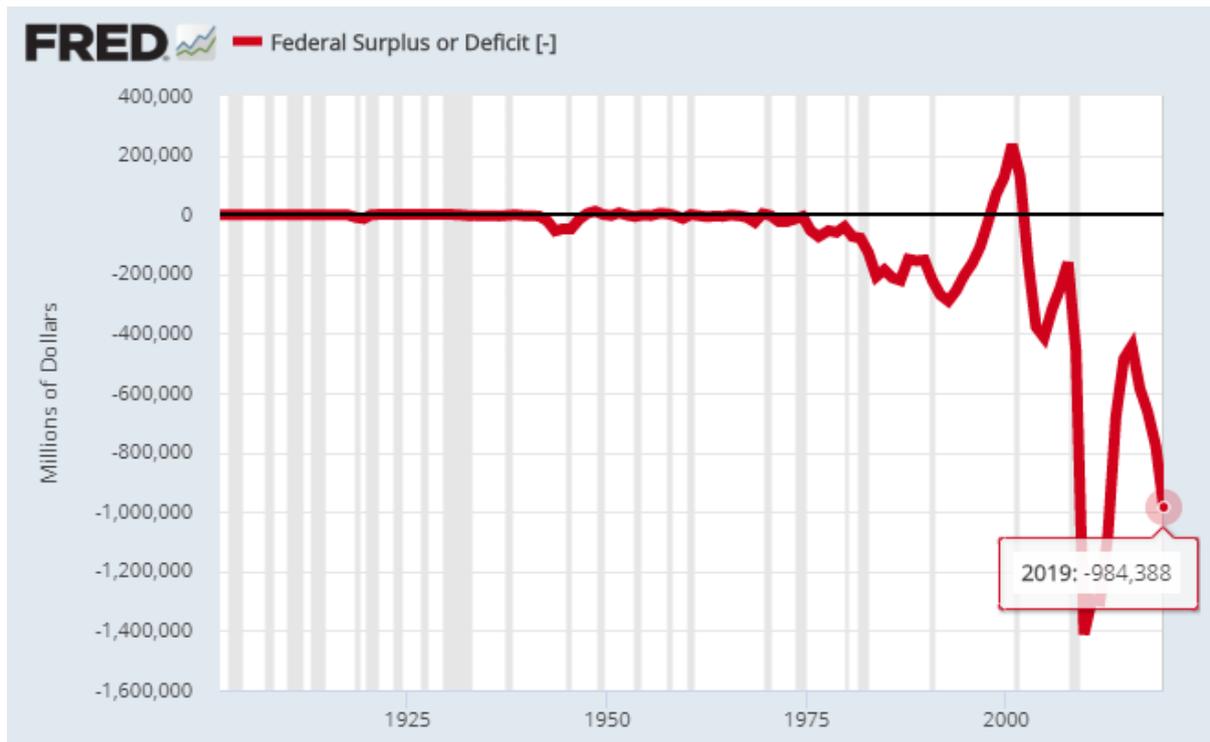
However, reality is the total opposite of what one should expect. The FED tried to increase interest rates and slowly decrease its balance sheet but steered away from that fairly quickly. As soon as there was a liquidity issue in the REPO market, the FED stepped in and quickly

reversed its balance sheet contraction policy and added half a trillion into the system.



FED balance sheet (blue - left) – FED interest rate (red - right) -Source : [FRED](#)

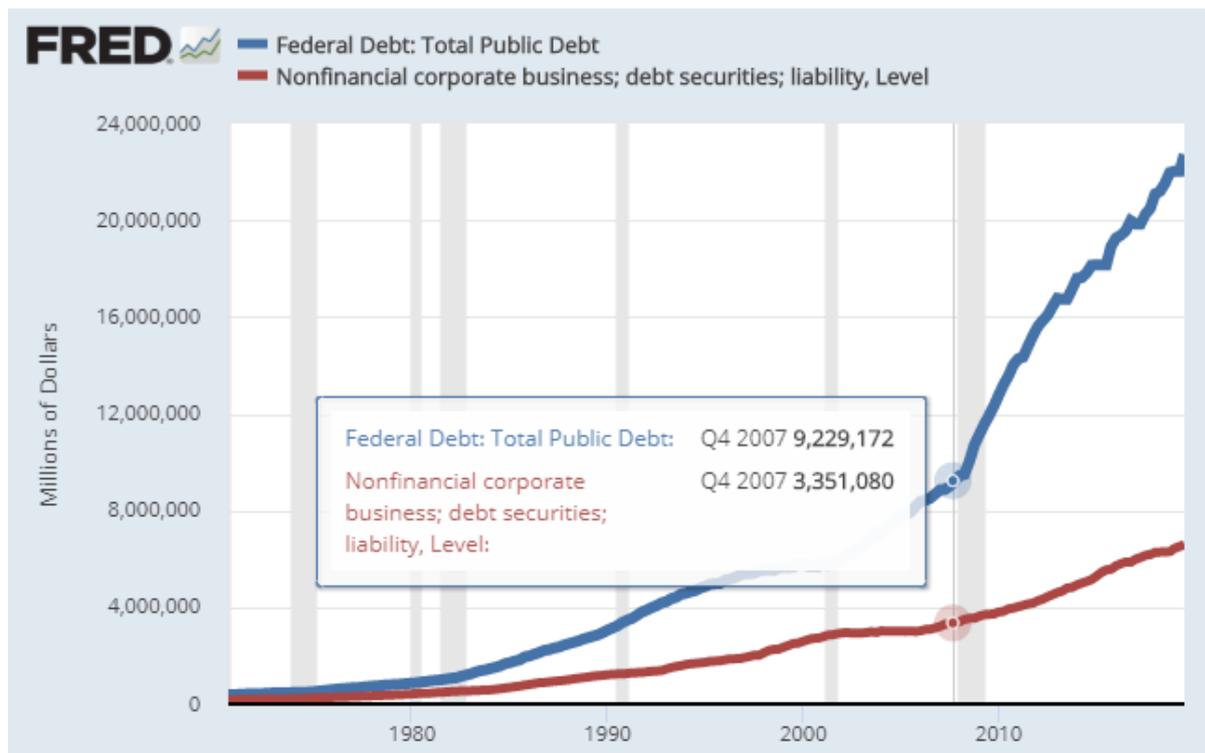
Similarly, the US government is spending like there is no tomorrow, or like all the future debt will simply be erased through inflation and money printing.



Federal deficit – Source: [FRED](#)

As the situation is similar in the most important economic hubs across the world like Europe and China, it is clear that cash will continue to be sacrificed to help service the staggering amount of debt governments and corporations have been piling.

Debt levels significantly increased over the past 50 years and exploded over the last 10 years thanks to the free money coming from the money printing through asset purchases and zero real interest rates.



Federal and corporate debt in the US – Source: [FRED](#)

What do you think is going to happen next?

When the next recession or slowdown comes – politicians will do the same thing they have been doing – they will print more money. This will lead to some kind of inflation depending on the policy applied, but one thing is pretty certain:

Given the staggering amount of debt, the best way for the governments to solve that issue is through money printing and the loss of value for the currency.

For example, if you borrow \$10 at a 2% interest rate per year and you have inflation at 5% per year, the real, not nominal, amount you have to pay back is much smaller than what you initially got. You have to pay your yearly interest cost, but after 5 years, the \$10 you borrowed have now a real value of \$7.73 as inflation chipped 5% of the real purchasing power away every year.

		year 1	year 2	year 3	year 4	year 5
INITIAL LOAN	\$100.00					
yearly interest	2%					
nominal payments		\$2.00	\$2.00	\$2.00	\$2.00	\$2.00
Inflation	5%					
real value of principal		\$95.00	\$90.25	\$85.74	\$81.45	\$77.38
real payments		\$1.90	\$1.81	\$1.71	\$1.63	\$1.55
final real payment						\$78.93

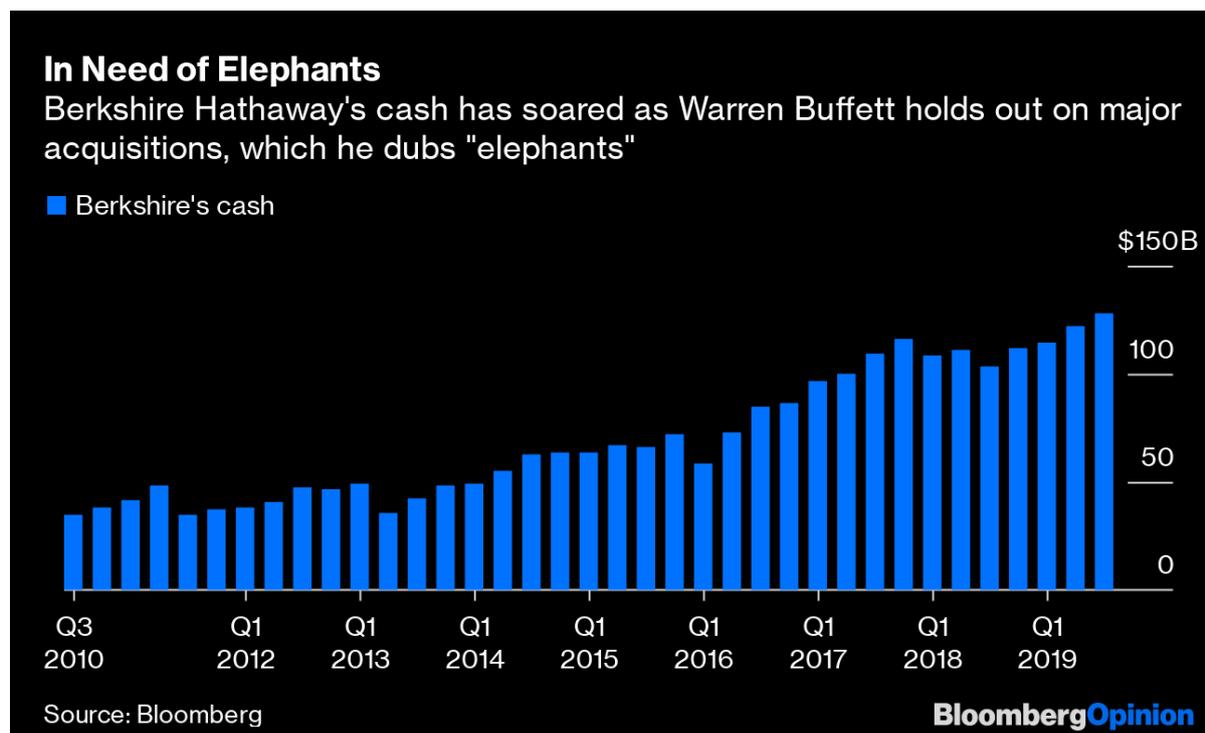
So, one thing is certain:

IF YOU HOLD CASH UNDER YOUR MATRASS, OVER TIME YOU CAN BE CERTAIN YOU WILL LOSE A LOT OF ITS REAL PURCHASING VALUE.

What to do when cash is trash and stocks are expensive?

Answering the what to do question is always the tricky part because nobody knows what will happen, nobody.

We have Dalio saying how cash is trash and on the other hand we have Buffett holding \$124 billion in cash as short-term Treasury bills.



Berkshire's cash or trash pile – Source: [Bloomberg](#)

It all boils down to being well diversified while owning hard assets and good businesses.

When it comes to Buffett, we have to understand that the \$122 billion in cash are just 15.7% of Berkshire's total assets. Therefore, we could say that Buffett is keeping a small safety cushion as he always does, especially when valuations are relatively high.

Item 1. Financial Statements
BERKSHIRE HATHAWAY INC.
and Subsidiaries
CONSOLIDATED BALANCE SHEETS
(dollars in millions)

	September 30, 2019 (Unaudited)	December 31, 2018
ASSETS		
Insurance and Other:		
Cash and cash equivalents*	\$ 71,064	\$ 27,749
Short-term investments in U.S. Treasury Bills	53,378	81,506
Investments in fixed maturity securities	19,172	19,898
Investments in equity securities	220,051	172,757
Equity method investments	17,535	17,325
Loans and finance receivables	17,135	16,280
Other receivables	34,511	31,564
Inventories	19,951	19,069
Property, plant and equipment	21,230	20,628
Equipment held for lease	14,934	14,298
Goodwill	56,478	56,323
Other intangible assets	30,788	31,499
Deferred charges under retroactive reinsurance contracts	13,359	14,104
Other	13,430	9,307
	<u>603,016</u>	<u>532,307</u>
Railroad, Utilities and Energy:		
Cash and cash equivalents*	3,712	2,612
Receivables	3,756	3,666
Property, plant and equipment	135,326	131,780
Goodwill	24,750	24,702
Regulatory assets	3,007	3,067
Other	14,915	9,660
	<u>185,466</u>	<u>175,487</u>
	<u>\$ 788,482</u>	<u>\$ 707,794</u>

* Cash and cash equivalents included U.S. Treasury Bills with maturities of three months or less when purchased of \$40.6 billion at September 30, 2019 and \$3.9 billion at December 31, 2018.

Buffett cash pile in portfolio – Source: [Berkshire financial statements](#)

Ray Dalio, who is more of a market player than a value investor like Buffett, prefers to play the market in a different way and just two months ago the story was that Bridgewater is betting big on the stock market crashing.

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Bridgewater Makes \$1.5 Billion Options Bet on Falling Market

World's largest hedge fund takes on a big bearish trade; founder Dalio says firm's overall position on market isn't negative



Bridgewater Associates, a hedge fund founded by Ray Dalio, is betting on a stock-market downturn. PHOTO: PATRICK T. FALLON/BLOOMBERG NEWS

Ray Dalio hedge – Source: [WSJ](#)

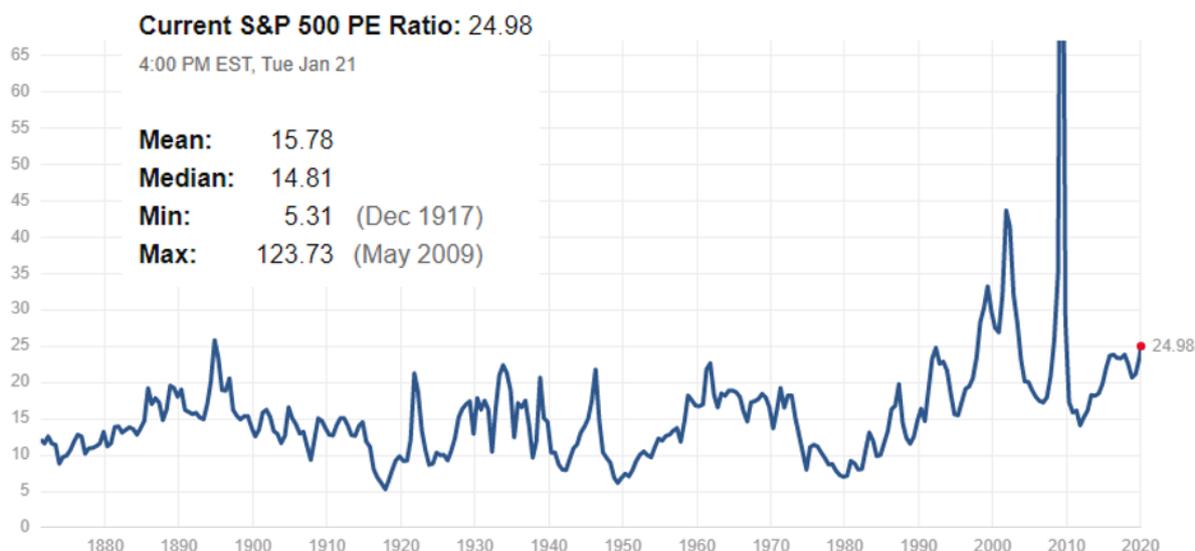
So, the message is simple – you have to see how a certain investment, asset class, financial burden or whatever fits your financial requirements.

I think that both Buffett and Dalio concur that the average investor should be diversified and be far away from cash for any longer term period. Let's discuss a bit of scenarios.

Cash vs stocks?

So, we have understood that cash is trash and that loss is unavoidable over time. But then, stocks are also extremely expensive from a historical perspective and those can always crash as we have seen in the chart showing 200 years of asset class returns. Stocks are much more volatile in comparison to other asset classes.

But currently stocks offer an earnings yield of 4%, which is better than what cash or bonds offer and one reason why to own assets in comparison to cash.



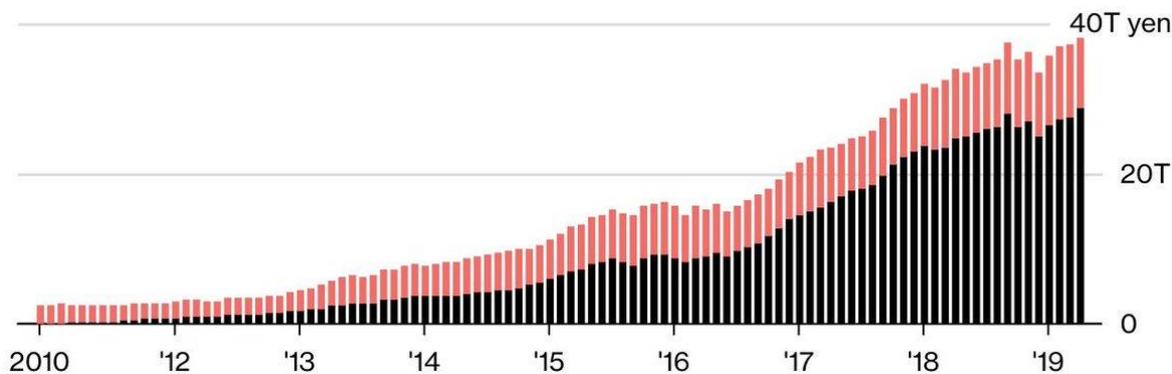
S&P 500 PE ratio – Source: [Multpl](#)

Further, what could happen in the future is what is already happening in Japan. The Bank of Japan is the largest owner of Japanese stocks. It owns more than 73% of the country’s ETFs.

Bank of Japan: The ETF Whale

Central bank estimated to own 73% of the nation's ETF market as of end April

■ BOJ holdings ■ Rest of market



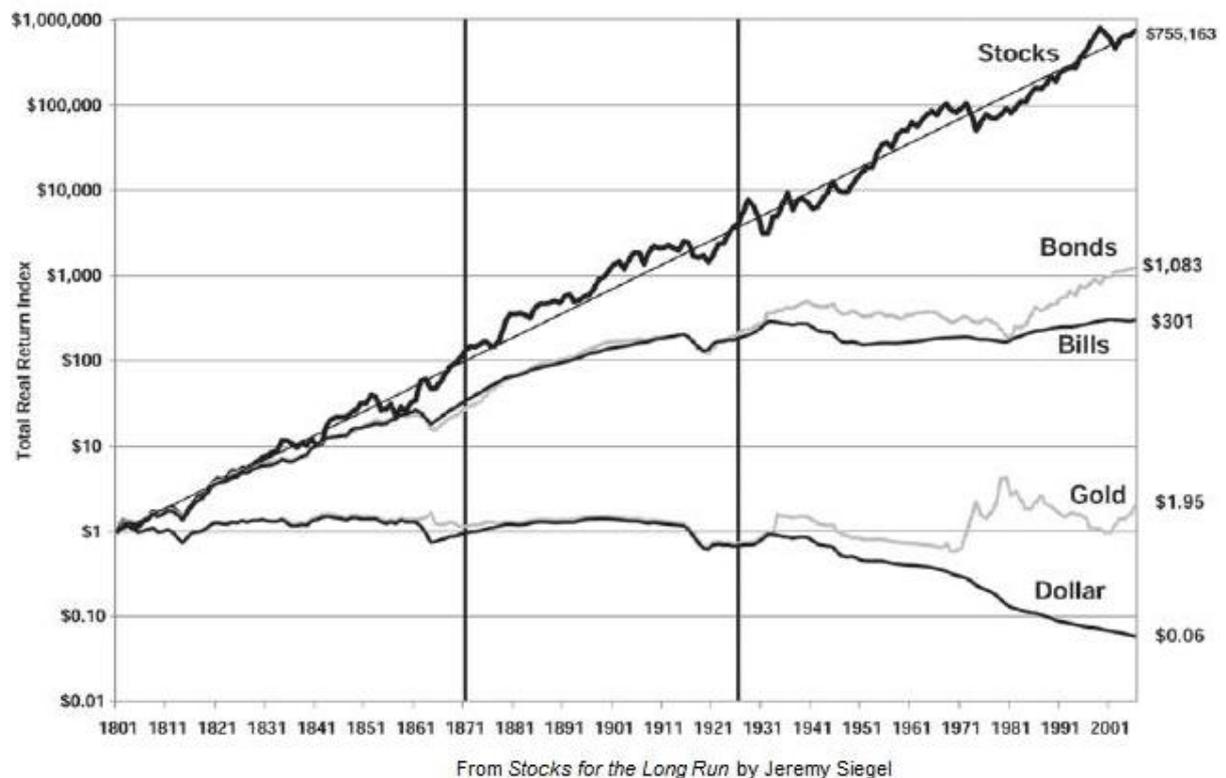
Source: Bloomberg

If a similar policy is applied in Europe, the US might follow, and we could see stocks reach new highs thanks to new market interventions by central banks.

Another benefit is that stocks, as those are businesses, offer some protection against inflation. We have seen how one dollar invested in stocks turned into \$755,163 real dollars over 200 years and how a dollar not invested turned into 6 cents of real value.

FIGURE 1-4

Total Real Return Indexes, 1802 through December 2006



The thing is that businesses can increase prices and that those hold real assets in the form of production facilities, real estate etc.

Thirdly, and this to cater to Dalio’s message that one should be diversified, global valuations are far from equal. I’ve recently been researching the top 25% dividend yielders in Hong Kong and there are companies across the globe that trade at price to book values below 1, thus offer some kind of real asset protection, have dividend yields above 5% and offer growth over the long-term.

Tickers	Name	Sector	Website	Yield	P/E Ratio	EPS	Price	Comment
HKG:6033	Telecom Digital Holdings	Telecomm. & Networking Equipment	http://www.tdhl.cc	9.06%	9.25	0.29	2.65	this is a hold
HKG:2788	YORKEY OPTIC	Industrial Goods	http://www.yorkey-optical.com	8.86%	12.25	0.06	0.79	another dec
HKG:1333	CHINA ZHONGWANG	Nonferrous Metal	http://www.zhongwang.com	8.68%	4.78	0.65	3.11	growth alon
HKG:0306	KWOON CHUNG bus transport	Public Transport	http://www.kcbh.com.hk	8.57%	6.17	0.45	2.8	LOOKS STAB
HKG:3828	MING FAI INT	Other Support Services	http://www.mingfaigroup.com	8.43%	6.66	0.12	0.83	China hotel
HKG:1127	LION ROCK GROUP	Printing, Publishing & Packaging	http://www.lionrockgroup.hk	8.33%	5.55	0.22	1.2	printing boo
HKG:3315	Gold Pac Group	IT Hardware	http://www.goldpac.com	7.78%	7.58	0.24	1.8	dividend grc
HKG:1373	International Housewares Retail Co	Furniture & Household Goods	http://www.japanhome.com.hk	7.77%	11.15	0.17	1.84	selling venti
HKG:0468	Greatview Aseptic Packaging Comp	Printing, Publishing & Packaging	http://www.greatviewpack.com	7.56%	12.01	0.3	3.57	hi dividend j
HKG:1212	Lifestyle international holdings	Departmentstores & Shopping malls	http://www.lifestylehk.com.hk	7.44%	6.46	1.38	8.94	retail HK sta
HKG:0034	Kowloon Development Co. Ltd.	Property investment	http://www.kdc.com.hk	7.37%	3.86	2.53	9.77	property
HKG:1628	YuZhou Properties	Property Development	http://www.yuzhou-group.com	7.34%	4.83	0.89	4.29	property
HKG:0659	NWS Holdings Ltd.	Conglomerate	http://www.nws.com.hk	7.14%	10.55	1.04	10.92	holding com
HKG:0900	Aeon Credit Service (Asia) Co. Ltd.	Other financials	http://www.aeon.com.hk	7.12%	6.53	0.95	6.18	no growth
HKG:0086	Sun Hung Kai & Co. Ltd.	Other financials	http://www.shkco.com	7.01%	6.46	0.57	3.71	6% delinque
HKG:0626	PUBLIC FIN HOLD	Bank	http://www.publicfinancial.com.hk	6.92%	6.89	0.46	3.18	bank
HKG:0367	Chuangs consortium	Property Development	http://www.chuang-consortium.com	6.85%	3.25	0.45	1.46	property ow
HKG:2033	Time Watch	Watch & Jewellery	http://www.timewatch.com.hk	6.77%	6.33	0.15	0.93	watches - sti
HKG:0008	PCCW Ltd.	Telecom Services	http://www.pccw.com	6.77%	40.69	0.11	4.61	the asian ne
HKG:0046	Computer and Technologies Holding	Software	http://www.ctil.com	6.73%	11.6	0.27	3.12	slowly grow

Source: [Stock Market Research Platform](#) – Sven Carlin

Dalio clearly says he can be wrong, but you have to see how the cash vs. stocks vs. other asset classes fits your investment requirements.

If you need the cash in the next few years, then it is very risky to invest it in something other than short term bonds or just hold it within your savings account because every asset class will crash at some point in time.

The answer is again diversification, and you have to see what best fits your requirements.

Cash and investing – an opportunity but also opportunity cost

Given that thanks to inflation and money printing, cash is certain to lose value, we can say it is trash. However, holding some cash is what enables investors to take advantage of opportunities created by the inherent volatility other assets classes show. .

For example, those that had cash in 2016 could take advantage of Apple’s stock cheapness. Those that didn’t have the cash, probably enjoyed returns elsewhere given the environment over the past years but then again it all boils down to risk versus reward of each potential investment.



Source: [CNN Money Apple stock](#)

The main message is simple, see what is your opportunity cost when owning cash and compare it to other opportunities out there. When you find an investment that will likely lead you towards your investment goals and also offers you the protection you need, then you buy that. It is as simple as that.

Skin in the game – my cash

To be transparent, it is always good to share what I have. My stock market portfolio as of January 2020 is heavily invested with 86.79% in stocks and the rest in cash waiting for opportunities.

STOCKS	149744.0793	86.80%
CASH	22778.73	13.20%
TOTAL	172522.8093	

Further, I still have a bit of cash that I got in September of 2019 when [we sold out house](#) but that is waiting to be deployed as we are looking for a new property to buy.

So, you could say that the cash I will have is very little and therefore my money is where my mouth is.