The Four USES of Cash

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What You Need to Know

By viewing your cash based on its "USES," you can:

- Be confident you have enough cash on hand to meet your day-to-day living expenses as well as for the unexpected
- Determine the cash that can be used as a source of investment for your long-term goals
- Provide a cushion for your spending needs and emergencies to help avoid selling longer-term investments during a short-term market decline

We know it's important to have cash available for our everyday spending needs as well as for the inevitable "rainy day." However, many of us have never taken the time to understand how much we really need.

And while it may seem like a good problem to have, having too much of your savings sitting in cash can be an issue, especially when you are investing for long-term goals such as retirement. Ultimately, your cash strategy can be a key factor in your long-term financial success.

To determine the role of cash in your financial life and how much you should have, we use the acronym "USES":

- **Unexpected expenses and emergencies:** Cash used for situations such as a job loss, a home repair or an unplanned medical expense
- **Specific short-term savings goal:** Cash dedicated for a goal that will occur within the next year or so, such as a wedding or vacation
- **Everyday spending:** Cash used to provide for your lifestyle, including day-to-day spending needs such as groceries, utilities, entertainment and your mortgage/debt payments
- **Source of investment:** Cash used as an asset class and as a source for investment opportunities

The priority of each of these pieces may change depending on your goals and objectives. For example, younger individuals who have a regular paycheque may find that building a fund for the unexpected may be the biggest priority. For retirees, the first goal may be to ensure you have enough for your everyday spending.

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How Much Should You Have?

Cash has benefits and trade-offs. It provides for your current spending needs and can serve as a cushion for the unexpected. On the other hand, cash generally earns a very low interest rate, which can make it a poor vehicle to achieve your long-term investment goals. So it's important to have the appropriate amounts in each of the above categories.

As you'll see, our guidance for appropriate amounts of cash depends on whether you are still employed, or whether you receive a regular paycheck, or income from Canadian Pension Plan (CPP)/Quebec Pension Plan (QPP), Old Age Security (OAS) and investments? Since these situations are different, we provide different guidance for each where appropriate.

	Pre-retirees	Retirees
U Unexpected Expenses and Emergencies	Three to six months of living expenses; supplemented by access to a line of credit (personal, home equity, etc.)	Up to three months of living expenses; supplemented by access to a line of credit (personal, home equity, etc.)
S Specific Short-term Savings Goal	Amount needed is based on your specific short-term savings goal(s)	
E Everyday Spending	One to two months of living expenses ("refreshed" by your next paycheque)	12 months of living expenses (excluding outside income sources)
S Source of Investment	0%–10% of fixed income (which is generally 0%-5% of your investment portfolio)	

U Unexpected Expenses and Emergencies

Description:

Cash for emergencies and unexpected expenses such as a job loss or an auto or home repair. This cash should be held in easily accessible, principal-protected accounts such as a savings account, money market account or short-term guaranteed investment certificate (GIC).

Establishing an emergency fund can help prevent the need to sell long-term investments or use your retirement accounts to meet a short-term cash need. Eliminating the need to sell long-term investments can be especially valuable during a short-term market decline, when these investments may be down in value. You may be better prepared to stick to your long-term investment strategy knowing you have cash set aside should the unexpected occur.

Recommendation:

» **Pre-retirees – At least three to six months of living expenses**

Job loss is a reality for many Canadians, and it is important to prepare for this unexpected event by keeping cash on hand. There is also always a risk of unexpected expenses, such as an unplanned auto repair or home repair. This recommendation is just a guideline – you may need more or less, depending on factors such as your job security and access to outside credit sources.

» **Retirees – Up to three months of living expenses**

Retirees face many of the same risks of pre-retirees, with the exception of a job loss. Since we also recommend having a larger amount of cash on hand to provide for your everyday living expenses (discussed later), you may be able to have a smaller emergency fund.

S Specific Short-term Savings Goal

Description:

Cash earmarked for a specific purchase or goal in the next year or two, such as a vacation, wedding, car, etc. This cash would be held in a savings account, money market or short-term GICs.

While this cash could be mixed in with your everyday cash, it is often separated (at least mentally), so you know what is targeted for this specific goal. Some people even have dedicated accounts – one for each goal. For longer-term goals (three to five years or more), we recommend considering investments with growth potential instead of keeping the money in cash.

Recommendation:

Work with your advisor to estimate the amount you need as well as the appropriate savings vehicle for your specific goal.

E Everyday Spending

Description:

Cash used to pay your day-to-day expenses. This cash is usually held in a chequing or cash management account and should be easily accessible and principal-protected.

To find out how much is enough, it's important to start with a word that makes some of us cringe – budget. But budgets don't have to be scary. In fact, they can help you see where you spend your cash, which could help:

- Potentially highlight areas where you could reduce your spending
- Determine how much you may have available to invest for your long-term goals

Recommendation:

» **Pre-retirees – One to two months of living expenses**

For pre-retirees, your everyday cash is replenished every couple of weeks by your paycheque. Therefore, having one to two months of living expenses in cash provides for your ongoing spending needs. Anything above and beyond your living expenses (and your emergency cash) can be directed to your investment accounts.

» **Retirees – 12 months of living expenses, adjusted for outside income sources such as CPP/QPP or OAS**

We believe it's important to have about a year's worth of living expenses in cash, after accounting for income from outside sources such as CPP/QPP or OAS.

In addition to your everyday cash, we also recommend building a ladder of GICs or other short-term investments that will mature annually over the next three to five years, which would serve as the short-term portion of your fixed income in your portfolio. This could help ensure your near-term expenses are covered should a short-term market decline occur. It could also help prevent having to sell your long-term investments to provide for your income needs when your investments are down in value.

Investors must evaluate whether a bond or GIC ladder and the securities held within it are consistent with their investment objectives, risk tolerance and financial circumstances.

S Source of Investment

Description:

Cash can play a role as part of a well-diversified investment portfolio. This role is typically one of the following:

- A strategic cash allocation as part of your fixed-income allocation – Cash can be viewed as a distinct asset class within fixed income. It tends to behave differently from other asset classes, such as stocks and bonds, and therefore can provide some diversification benefits.
- A temporary allocation to cash targeted for future investment – You may have cash you have recently deposited in your investment account, or from an investment that has matured, that you are targeting for reinvestment.

Recommendations:

» **Strategic allocation**

Based on our outlook for interest rates, the markets and the economy, we recommend 0%–10% of your fixed-income allocation in cash (which would likely be about 0%–5% of your overall investment portfolio). This recommendation may be adjusted as our long-term outlook changes.

Asset Class Allocation Range
(as a percentage of Overall Fixed-income Allocation)

	Recommended Ranges
Cash	0%–10%
U.S. Investment-grade Bonds	75%–90%
U.S. High-yield Bonds[1]	0%–15%
International Bonds[1]	0%–10%

1 The total amount in U.S. high-yield and international bonds should not exceed 10% of your overall portfolio.

» **Temporary Allocation**

This is temporary cash, so it should be invested based on an agreed-upon schedule between you and your advisor.

Since this is cash you are targeting for reinvestment, you may wonder, "When is the 'right time' to invest?" In our view, the best time to invest is when you have the money available. One way to take timing (as well as emotions) out of the investing decision is through dollar cost averaging (DCA). DCA is a strategy designed to help you purchase more shares when the price is low and fewer shares when prices rise.[2] It can help smooth out the price you pay for your investment (i.e., cost averaging) as well as help maintain discipline in your investing decisions.

2 Dollar cost averaging does not ensure a profit or protect against loss. Investors should consider their willingness to keep investing when share prices are declining.

Using Cash Wisely

Cash has many USES, whether it is providing for an unexpected event, a short-term savings goal, your everyday expenses or even a source of investment. By ensuring you have each of these areas covered, you can better focus on your longer-term goals, including preparing for retirement and paying for education. Schedule some time now with your advisor to review your USES of cash.

The Risk of Not Investing

Some people hold too much in cash, viewing it as a safe haven against the risk of a market decline.

But cash is not risk-free. There are also risks of not investing. If this cash is designated for long-term goals such as retirement or education, you may face an even bigger risk than a short-term decline. In fact, the biggest risk you face isn't a temporary pullback in the market – it's the possibility of not reaching your long-term goals.

If you have your cash needs covered as outlined in the USES framework, then it is important to focus on the growth necessary to help achieve your long-term investment goals.