

# Imminent Fed rate cuts raise the risks of holding excess cash

## Investment strategy insights

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- CIO expects the Federal Reserve to cut rates by 25bps this month and by 75bps more thereafter, joining other major central banks in reducing returns on cash.
- We see merit in building a robust cash management strategy to meet liquidity needs up to five years out, then putting additional cash to work to generate income and aim to preserve and grow wealth.
- CIO likes shifting surplus cash into diversified portfolios—especially quality bonds and equities—to help investors preserve income, reduce volatility, and capture long-term corporate profits growth, especially linked to innovations like AI.



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A number of major central banks meet this week to decide on the interest rate outlook. Markets will be most closely watching the Federal Reserve, with investors widely expecting a 25-basis-point cut, the first since December last year.

Many investors, especially those for whom the ups and downs of policy, geopolitics, and markets have been hard to bear in 2025, have chosen to manage their cash by locking it into short-term fixed-term deposits (FTDs) for just a month or two, then rolling into comparable instruments while they await greater economic, policy, and market clarity.

This approach may seem prudent at first glance.

But with the Fed set to cut rates and with many European central banks already advanced in their easing cycles, this course of action may expose investors to rising reinvestment risks and the prospect of negative after-inflation returns.

We outline a three-step approach for prudent cash management that can both maximize the chances of having funds on hand when needed and support long-term financial goals to protect, preserve, and grow wealth.

### Step 1: Ascertain how much cash to hold

While holding cash can feel safe, especially in uncertain times, investors should be wary of holding excessive liquidity. CIO recommends that investors maintain enough cash to cover 2-5 years of net expected portfolio withdrawals. This range is based on historical recovery periods for balanced portfolios (stocks and bonds) following their worst drawdowns. If an investor holds more than this, their excess cash may not be working efficiently toward long-term financial goals.

Excess cash often sits idle, earning little or no real returns, and is vulnerable to inflation erosion. For example, Swiss investors are now facing a zero-interest-rate environment, with the Swiss National Bank (SNB) policy rate at 0% and with many short-term government debt instruments below two years' maturity trading with negative yields. In this context, holding large cash balances may result in negative after-inflation returns, eroding purchasing power over time.

History shows that phasing excess cash into diversified portfolios delivers more robust long-term outcomes. CIO analysis finds that since 1945, cash has underperformed

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a strategy of phasing into diversified portfolios of US stocks and bonds on around 74% of 1-year horizons and around 83% of five-year horizons. By gradually investing excess cash into a mix of stocks, bonds, commodities, and alternatives, investors can reduce the risk of poor market timing and benefit from market dips and rebounds.

## **2. Avoid the temptation of very short-term deposits that forego returns**

Given the current interest rate outlook, rolling over very short-term deposits can expose investors to significant reinvestment risk. In the US, we expect the Federal Reserve to cut by a total 100bps by early next year. This is in response to slowing labor market activity and what are expected to be one-time, rather than persistent, price effects from higher import costs. As a result, the yield advantage of short-term deposits is likely to diminish as rates fall.

Rates are already low in Europe, and the Swiss National Bank has indicated that further cuts are possible if global trade tensions escalate or the franc appreciates further. In this environment, the risk of negative after-inflation returns is real for Swiss investors.

Instead of rolling over short-term deposits, investors should consider locking in currently elevated yields with longer-term fixed-term deposits or high grade (HG) bonds. Even in markets where absolute yields are low, holding bonds may be superior to cash, especially when considering the potential for capital gains if growth underwhelms market expectations and rates fall further. In the US, high-quality government bonds offer an appealing risk-return profile, in our view, particularly in a scenario where economic growth could weaken further. We therefore still think it makes sense to invest in bonds, especially those with medium-term (around 5-year) maturities.

## **3. Explore alternative ways to put cash to work through a cash management framework**

A thoughtful cash management strategy involves segmenting liquidity into three categories: everyday cash, core liquidity, and investment cash.

- Everyday cash, for spending needs up to one year, should be readily available and takes little to no interest rate, credit, or market risk. Deposit programs, money market funds, or certificates of deposit offer relative stability in exchange for modest yields.
- Core liquidity, covering known expenses or emergencies over a one- to three-year horizon, should balance flexibility and yield. A bond ladder—a portfolio of individual bonds or fixed maturity bond funds with staggered maturities—can provide predictable cash flows and manage interest rate risk. Structured strategies with capital preservation features may also be considered,

aiming to capture market gains while curtailing losses, so the original capital is returned at maturity.

- Investment cash, earmarked for needs up to five years out, shifts the focus from immediate access to maximizing returns while accepting some price fluctuation and lower liquidity. This allocation is best built using medium-term government or investment grade bonds, as well as diversified multi-sector bond investment approaches.

Beyond bonds, investors can consider equity income strategies—Swiss dividend-paying stocks currently yield above 3% on average, well above the historical average of 2.4% and higher than most Swiss franc bond yields. Structured strategies, like reverse convertibles, can generate yield while waiting for better equity entry points, though they carry issuer and liquidity risks.

Investors can also find ways to reduce reliance on excess cash in the context of a broader financial plan. Opening up borrowing capacity can reduce the need to hold excess cash for unlikely events.

### **Risks to consider when managing cash**

Managing cash is not risk-free. Investors must weigh counterparty, credit, liquidity, and reinvestment risks, as well as the potential for negative real returns in low or negative rate environments. Matching risk to time horizon, diversifying across instruments, and regularly reviewing allocations are essential to preserving and growing wealth.

## Appendix

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