HOLDING CASH IN TODAY'S MARKET

3 THINGS TO KNOW

The stock market has taken some wild swings over time, especially in the past few months. For some investors, this volatility and the fear of losing money can make it tempting to exit the market altogether. But there are risks to making such a move, especially for younger savers, says Stuart Ritter, CFP®, a senior financial planner at T. Rowe Price.

Here's what Ritter recommends considering before you make any big investment changes:

1 SHIFTING YOUR STOCKS TO CASH COULD HURT YOUR RETIREMENT GOALS.

When it comes to long-term savings, sticking to your asset allocation plan—a mix of stocks and bonds tailored to your age and risk tolerance—is one of the best ways to ensure you'll have enough money to retire. Moving into cash too early could create a shortfall at retirement. The more money you move to cash, the bigger effect it will have, Ritter says. And the younger you are, the worse it will be, since you'll be getting a lower return of cash over a longer period of time.

For example, a 50-year-old planning to retire in 15 years who moves her investments to all cash could end up with 26% less savings at retirement than if she had stuck with her diversified portfolio. And a 25-year-old who shifts his current recommended all-stock portfolio into all cash may have just a third of his needed retirement savings by age 65, according to Ritter's analysis.

2 YOU CAN BALANCE CHANGES TO YOUR ACCOUNT BY SAVING MORE.

If you still want out of the stock market, you can hit your retirement goals with an all-cash portfolio—but you'll need a much higher savings rate. The 50-year-old in the previous example would need to boost her savings rate from 15% to 20% to make up for the gains she'd be missing by going to all cash. And the 25-year-old would need to save almost half his salary for retirement for the rest of his working life.

3 NOT ALL CASH OPTIONS ARE EQUAL.

Those who have a portion of their retirement portfolio, emergency fund, or other investment account in cash should be smart about where they're keeping it. As interest rates climb, there are ways you can get more return on cash accounts without much risk to the principal. You might keep cash you need within six months in a high-interest savings or money-market account, and money you are holding longer in an ultra-short-term-bond fund.

The right amount of cash in a portfolio depends on multiple factors, including your risk appetite and the amount you can save. While investors may not be able to control the ups and downs of the stock market, understanding the implications of moving to cash—and making smart decisions about the cash you do hold—can help you decide which options will help you best achieve your financial goals.

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