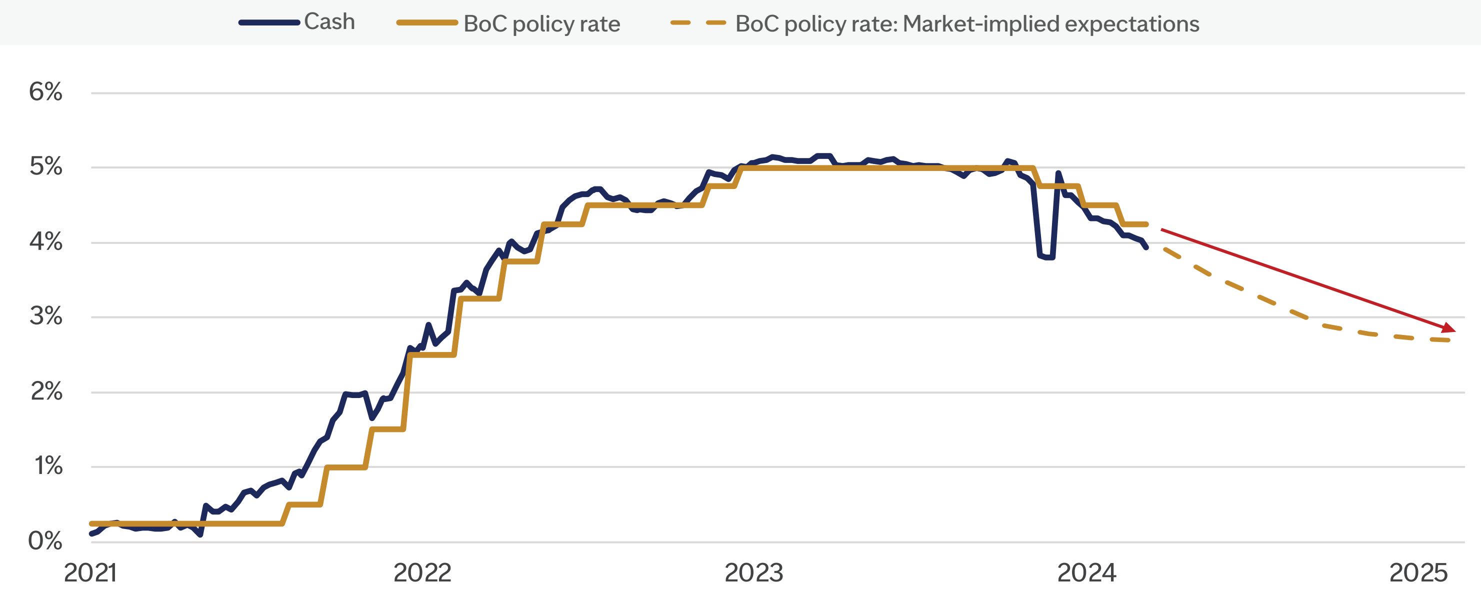
The Bank of Canada and cash yields

Bank of Canada rate cuts likely to drive cash yields lower



Source: FactSet, Bloomberg and Edward Jones.

Cash yields typically rise ahead of Bank of Canada (BoC) interest rate hikes and drop before rate cuts. As the BoC likely continues cutting interest rates, we expect cash yields to fall further.

Some investors may be overweight in cash, including money market funds. Investments in these funds increased over the past few years as their yields rose along with BoC rate hikes. Holding too much cash can present risks, such as the potential for lower returns over the long term.

Cash yields likely to fall further — With inflation moderating toward the middle of the BoC's target range of 1.5%-2.5%, monetary policy can be less restrictive. Further rate cuts could cause cash yields to decline more than intermediate- and long-term yields, likely steepening the yield curve and increasing reinvestment risk on cash, including money market funds.

Some investors may be overweight in cash — We include money markets funds in the cash asset class due to their strong liquidity, high quality and price stability. Money market funds experienced substantial investment inflows over the past few years as their yields rose along with BoC rate hikes. As a result, some investors may now hold more cash than they need.

Overweighting cash can present risks — Cash can provide important benefits, such as funds for unexpected expenses and emergencies, specific short-term savings goals and everyday spending. It also can serve as a strategic allocation for investment and a source for investment opportunities.

However, holding too much cash can present risks, including the potential for lower returns, especially when investing for long-term goals. For perspective, since 2002, Canadian large-cap stocks have delivered annualized returns of 9.4%, compared with 4.0% for Canadian investment-grade bonds and 1.9% for cash.

While past performance does not guarantee future results, we expect this general relationship to hold over the long term, with equities outperforming bonds and cash lagging most asset classes. Investors who are overweight cash may want to consider reinvesting a portion of these funds.

▶ Action for investors

Consider reinvesting any overweight in cash to underrepresented asset classes or potentially overweighting those where we see current opportunities, such as U.S. large- and mid-cap stocks.

