



Summit
160 Bovet Road
Suite 405
San Mateo CA, 94402
info@summit-advisors.com
650-357-9410

Mark Pietrofesa

mark@summit-advisors.com
650-357-9410

Rafael Velez

rafael@summit-advisors.com
650-357-9410

William Fisher

william@summit-advisors.com
650-357-8812

Michael Radakovich

michael@summit-advisors.com
503-445-6661

Cristina Petersen

cristina@summit-advisors.com
650-357-8812

Smart Cash Management for Volatile Times

To guard against additional losses, many investors have sold off some or even all of their portfolio holdings. Cash instruments can seem particularly attractive right now considering the market's condition, but they differ in terms of performance and protection features. Given these variables, it pays to explore your options.

SAFE, BUT SMALL RETURNS

Cashing out is safe short-term route for preserving your assets. However, reduced interest rates diminish the potential for more significant returns on cash investments. And considering the high levels of cash injections the federal government is putting into the market, inflation over the longer term should be an ever-present concern. "The Fed is going to keep interest rates low for an extended period of time," says Greg McBride, senior financial analyst at Bankrate.com. "Investors need to keep the word *inflation* fresh in their minds. Settling for low returns runs the risk of losing buying power in the face of higher inflation." It pays to try to stay one step ahead by finding the best yields possible with your cash investments.

U.S. Treasury bond rates during the past year exemplify the potential downside of cash holdings. A year ago, six-month Treasury bills were earning slightly more than 3%. But as investors sold stocks and rushed into government-guaranteed Treasuries, yields on the six-month T-bill dropped to less than 1%.

SEEK ALTERNATIVES

Where bonds have recently slid, certificates of deposit (CDs) have proved to be an attractive alternative. According to Bankrate.com reports, the average six-month CD yield was 2.05% as of January 11. The average five-year CD was yielding 2.98%. Still, these are only averages: Investors who shop carefully may find higher-yielding instruments. What's more, the Federal Deposit Insurance Corp. (FDIC) recently increased its deposit insurance on conventional bank accounts and CDs to \$250,000 (from the previous \$100,000) through December 31, 2009.

"The top-yielding banks trump what you'll find in either money market funds or Treasury bonds without having to incur any investment risk," McBride says. CDs, which are typically available in one-month to five-year maturities, yield interest plus principal at maturity. When in a cash position, returns on high-yielding bank CDs and savings accounts are the best options, according to McBride.

LADDERS, NOT CHUTES

When choosing CDs as investment vehicle, one option is to "ladder" a portfolio of various maturity dates. To do this, you might consider buying a number of three-month, six-month and nine-month CDs. If interest rates go up, you can reinvest funds from the three-month CD into another CD at the new, higher rate. If interest rates fall, at

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Continued from page 1

least you have locked in some higher yields on the longer CDs. In fact, investors following this strategy now are likely reaping the benefits. These individuals would have invested a good portion of their cash when yields were higher. It's a good strategy to keep on the radar, but at this point, McBride advises waiting for rates to tick up before laddering out too far. "A month ago it was really compelling to lock in a 5% yield, but today, with yields of 3.5% or so on longer maturities, it's less compelling over a multiyear period."

MONEY MARKET FUNDS: WHAT YOU SHOULD KNOW

Money market funds invest in short-term, highly rated debt securities. Recently they have been offering rates of less than 1%—and the FDIC does not insure them. However, the Treasury Department has instituted a temporary guarantee on money fund assets through April

2009. It did so because last year a prominent money fund "broke the buck" by dropping below the \$1 per share target, meaning \$1 invested returned less than that \$1, and the markets seized up. This protection extends only to funds that existed before September 19, 2008, and is subject to additional provisions.

Still, for liquidity, McBride notes that bank savings accounts and money market (or high-yield savings) accounts are probably your best option. Both currently deliver higher returns than money market mutual funds and offer FDIC insurance as well as instant access to cash.

It's important to carefully evaluate your options when considering a cash strategy. Finding the right combination of safety, yield and liquidity will enable you to keep pace with inflation and enjoy the peace of mind that comes from knowing your assets are safe.

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