How Much Cash Should You Hold?

Description

How much cash you should hold as a part of your portfolio depends on multiple factors, including if you owe any money, the size of your emergency fund, and if you earn an active income or not.

Do you have any debt?

Generally, we should pay down the most expensive debt first–the debt that charges the highest interest rates–namely, credit cards. Of course, mortgage payments are also mandatory if you have a mortgage. After that, pay down other debts such as lines of credit.

Emergency fund

Some people have less than $1,000 as their emergency fund. But we should have an emergency fund that's a minimum of three to six months of our living expenses.

If you're a retiree, you might feel more comfortable with enough cash set aside to last you a year or a few years in case the stock market goes down if you'd rather not liquidate your stocks during a down market.

Some people choose to have one year of living expenses set aside and two years' worth of living expenses in laddered GICs. Essentially, you can access different buckets of cash other than your stock portfolio when the market falls.

Ideally, investors can get to a point where they don't need to worry about whether the market is falling or not because they'd bought quality dividend stocks a long time ago and the passive income generated covers their living expenses.

Are you earning an active income?

If you're earning an active income, you might opt to hold less cash. On the other hand, retirees should hold more cash to help insulate volatility from their stock portfolios.

That said, with interest rates so low, cash is earning close to nothing, but you can commonly find quality stocks with dividend yields of 3-4%, including **Emera Inc.** (TSX:EMA) and **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM).

Imagine earning less than 1% in your bank account and earning two to three times more with dividend stocks. It makes a big difference when investing for the long term.

If you invest $1,000 for 1% for three years, you'll earn $30. If you invest for 3% or 4%, you'll earn $90 and $120, respectively. The difference is more prominent the longer you stay invested and if you reinvested the yields.

Conclusion

Some people hold as little cash as needed because it earns close to nothing in today's low-interest rate environment. However, holding cash reduces the volatility in our overall portfolios and makes it more bearable if the market falls. The more uneasy an investor feels, the more cash they should hold for peace of mind.

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:CM (Canadian Imperial Bank of Commerce)
2. TSX:CM (Canadian Imperial Bank of Commerce)
3. TSX:EMA (Emera Incorporated)

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