10 Strategies for Investing Large Amounts of Cash

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When you find yourself with a large amount of cash, it can feel somewhat overwhelming to figure out what to do with it. Should you use it all to pay off debt? Splurge on that big-ticket item that you've been telling yourself you'd get "someday"? What about investments and saving for retirement?

In this guide, you'll learn about 10 different actions you can take to manage your cash and develop a strategy to set yourself up to achieve your financial goals.

Let's get started!

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Strategy 1: Build a Plan for the Long Term

The word "retirement" means different things to different people. For some, images of slow breakfasts and golf jump out. For others, it's traveling the world.

Your retirement is unique to you, and using your cash to set yourself up for success between now and retirement is key to your long-term success. Knowing what you want your future retirement to look like can help your current self determine which types of investments to make now.

To start, build a short list of statements of things you would love to do, see, or experience during your retirement. Starting with concrete, written goals you'd like to accomplish during retirement both builds your commitment to achieving these goals and makes it more likely you will accomplish them.

Visualize your ideal retirement. What does your time horizon look like? How much money do you want per month at your disposal? Are there any activities or purchases that you'd like to make during retirement, such as travel or a second home?

Below is some space you can use to write your retirement goals:

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Strategy 2: Build an Investment Strategy

A key component of your long-term plan should be a long-term investment strategy. And when it comes to the types of investment vehicles available, you have four choices:

1) Stocks: you become one of the owners of a company and turn your investment into more money through dividends and capital gains. Individual stocks are the most volatile of the four types, and investors can expect significant swings in their value.

2) Index Funds: a fund in which the money within the fund is invested into the companies that are part of a certain index, such as the S&P 500. For example, VOO, Vanguard's S&P 500 Index Fund, contains nearly all the stocks in the S&P 500. Because index funds have hundreds of stocks in them, it is less risky than owning a single stock - the value of the index will be less affected by the swings of a single stock. Index funds, especially ETF's, have become very popular over the last few years.

3) Bonds & Bond Funds: securities that will pay out a set amount of income at regular intervals, typically twice a year. Individual bonds are issued by a company in the form of "debt" where the bondholder becomes the lender. As a bondholder, you are entitled to interest payments on your bonds. "Investment grade" bonds are higher-quality bonds that are less risky because the companies issuing the bonds have higher credit ratings, like AAA or AA. "Junk bonds" are bonds issued by companies with lower credit ratings; while they offer higher returns, they are considered more risky because the company issuing these bonds is less stable. Bond funds, like index funds, carry many bonds within them and reduce the risk from a single company causing swings in the funds.

4) Cash & Cash Equivalents: short-term investments that have a maturity period of 90 days or less. Cash and cash equivalents refer to investments like U.S. Treasury bills or bonds that do not offer much in terms of appreciation but are aimed at being a "temporary store of value". Some index funds also replicate cash equivalents.

All the investable assets above are also known as "securities," or investments that trade on the markets.

Generally, a portfolio is built using different combinations of the four securities we outlined. For a young 20-something who has just started their career, their long time horizon means they can take on significantly more risk in their investment portfolio because if the market dips, they have plenty of time to make up for the downturn through their future earnings.

As retirement approaches, your investment horizon shortens, which is typically accompanied by changes in your portfolio. For example, an investor with only five years until retirement will generally have more bonds, bond funds, and fixed income investments in their portfolio because these investments are lower risk. Similarly, if an investor wanted to protect the current value of their portfolio (because they have a large purchase, like a house, coming up), they would allocate a good portion of their capital toward fixed income securities.

Strategy 3: Know the Difference between Equity and Fixed Income

In all investment vehicles, there is an inherent risk-reward relationship. Historically, higher risk has correlated with higher potential returns. More risk means more volatility, including more exposure to swings in the market. Conversely, less risk has less potential upside, but in exchange you receive greater portfolio stability over time.

In equity markets, such as stocks and index funds, there is more risk, but there are also higher potential rewards. We talked about it a little bit earlier, but when an investor owns a single stock, they become a part-owner of a company (in equity, or share of ownership). This introduces what we call *company risk*, which is the risk (volatility in stock price) associated with the management of a company. This kind of risk is most present in stocks.

In index funds, the company risk is diversified away because of how many individual

stocks are wrapped up in one "box" of an ETF. However, investing in sector-specific stocks (like retail stocks, for example) opens a different kind of risk: *sector risk*. This kind of risk is the risk that an entire sector is exposed to. For example, during the pandemic, restaurants shuttered when they saw sales drop due to lockdowns and restrictions in foot traffic. This kind of risk affected the whole restaurant sector – it would have affected prices, regardless of whether you owned one restaurant stock or many. Individual stocks are also exposed to sector risks.

In fixed income markets, you have more stability, but you also experience lower potential returns. Because bonds are tied more to credit ratings of a company and general interest rates, some company risk is still present. But because they depend less on performance of the company and more on the stability of the company, bonds are relatively less risky.

Similarly, a bond fund reduces company risk. While a bond fund is still exposed to sector risk, the risk is minimal because it takes into account the steadiness of an industry.

Knowing how risk affects different securities is important because you can use these rules of thumb to build a diversified portfolio. For example, building a portfolio heavily weighted to stocks and index funds opens the door to a significant amount of risk, but also to potentially greater returns. For someone a long way from retirement, this portfolio may give them the head start they need to generate significant returns. For someone close to retirement, this portfolio may be too risky – if it were to lose 20 percent of its value in the short term, their retirement plans could be impacted. This is something we want to avoid. The investor closer to retirement may want to allocate more capital to bonds and bond funds to reduce the overall risk of the portfolio while still maintaining a stream of income.

Building a diversified portfolio is important, and a good portfolio incorporates and reflects the investor's current financial goals and objectives. Make sure the overall risk in your portfolio is right for your goals and retirement timeline.

Strategy 4: Set Some Aside for an Emergency Fund

It's always a good idea to have a cash reserve set aside that's readily available for

unplanned emergencies. You never know what life is going to throw at you – an unexpected car repair, home or appliance repair, or medical bills – so you want to ensure that you have some cash available and ready to use.

Earlier, we talked about cash and cash equivalents. These kinds of instruments are well suited for setting aside cash without losing significant value to market volatility. They are highly liquid, meaning they can be converted to cash very quickly, and are relatively unaffected by movements in the stock market. Using cash equivalents to hold emergency fund cash keeps the cash safe and accessible.

How much you set aside for your emergency fund is up to you. The general rule of thumb is for the fund to contain two to three months' worth of income. However, your emergency fund may contain more or less, depending on your lifestyle.

Strategy 5: Plan for Large Purchases

Is there a large purchase coming your way within the next three years, like a new house? If so, now is a great time to start planning for how you're going to pay for it.

You'll want to take down payments and other financing options into consideration when looking into making a large purchase. A down payment is an initial sum of cash that you pay up front to cover part of the cost of purchase. The rest of the payment is covered by a loan. The larger the down payment, the less you'll have to borrow for the loan – which could save you money on interest payments and allow you to pay it off sooner.

Your strategy for achieving your down payment goal should be stability and liquidity – you want your money to be readily available and retain as much of its current value as possible. To achieve this, look into investment vehicles that have low risk and high liquidity, such as short-term bond funds.

Short-term bond funds allow for some appreciation/yield in the form of bond payments while minimizing the risk that the value of your down payment will depreciate.

Strategy 6: Build a Balanced Investment Portfolio

When it comes to an investment portfolio, you want to ensure that it's as balanced as possible in the medium to long term (more than three years) so you can reach your investment goals.

A balanced portfolio strategy would take something like a 60/40 approach - 60 percent of your portfolio should consist of stocks and equity index funds, and the remaining 40 percent should be bonds and fixed income funds.

The 60 percent allocation to stocks and index funds, while creating exposure to risk, opens the portfolio up to capital appreciation in the form of investment returns. Historically, equity markets have returned an average of seven to ten percent annually. While the annual swings in the market have been significantly larger, investing in equity over the long term has proven to be a net positive for investors.

The other 40 percent in a balanced portfolio would be allocated to bonds and bond funds, adding stability to the portfolio to counter the risk from the allocation to stocks and index funds. The fixed income side of the portfolio generates cash flow in the form of bond yields while reducing the overall risk of the portfolio.

Strategy 7: Strengthen Your Retirement Accounts

Now that we've covered the basics of the kinds of securities and how to build a balanced portfolio, we can take a look at another powerful tool: retirement accounts.

There's a lot you can be doing now with your cash that can help you achieve your retirement goals. Investment vehicles that have time horizons of more than five years, such as a traditional IRA or a Roth IRA, are worth adding to your portfolio.

In a traditional IRA, any contributions you make to the account are not taxed, and any growth in the account is tax-deferred. You begin paying income tax on the money once you've retired and have started taking withdrawals from the account.

This means the investment gains you realize in these accounts are not taxed, and the only tax you pay is when you are withdrawing money from your IRA after you reach retirement age, which is defined as 72 years old.

Alternatively, in a Roth IRA, your contributions are made with post-tax dollars and are not deducted from your taxes in the year you make the contributions. However, it is tax-free when you take the money out of the account during retirement. You may also make withdrawals prior to retirement for emergencies if you meet certain requirements. With a Roth IRA, there is a five-year waiting period before you can withdraw. Capital withdrawals from a Roth IRA before the initial five-year period has passed will result in a penalty for early withdrawal.

Both types of IRAs have annual contribution limits that can sometimes change. For 2022, the contribution limit is $6,000 ($7,000 if you're over age 50). You want to put as much money into your IRA each year as possible (while still being able to cover your expenses and lifestyle) so you can reach your retirement goals.

Strategy 8: Dollar Cost Average into Your Investments

Dollar Cost Averaging (DCA) is an investment strategy in which you take a sum of money and invest it in equal portions at regular intervals over a period of time, regardless of changes in the market.

With this strategy, you end up buying more shares of an investment when the price is low and fewer shares when the price is high. Over time, this can lead to a lower overall price per share and can remove the temptation to try to "time" the market. And, bonus, you could potentially minimize your losses if the market dips.

For example, let's say you have $100,000 that you're looking to invest. Instead of investing it all at once, you could work with a financial advisor to build out a dollar cost averaging schedule to invest that $100,000 over time.

Your schedule could look something like this:

Month 1:
- $17,500 buy SPY
- $7,500 buy VBLTX

Month 2:
- $17,500 buy SPY
- $7,500 buy VBLTX

Month 3:
- $17,500 buy SPY
- $7,500 buy VBLTX

Month 4:
- $17,500 buy SPY
- $7,500 buy VBLTX

In this scenario, you'd not only be dollar cost averaging, but you'd also be creating a 70/30 equity-to-bonds capital appreciation portfolio.

While this is one example of what a DCA schedule might look like, it can also involve as many different securities as you'd like. A more comprehensive DCA schedule might include many securities, with many trades being placed each month as the investor moves into their position.

Strategy 9: Designate or Update Your Beneficiaries

When you experience any changes in your financial situation, it's a good idea to re-evaluate your estate plan and designate or update your beneficiaries.

In most estate plans, there are primary and contingent beneficiaries. Your primary beneficiaries (yes, you can have more than one) are the people who are first in line to receive your assets upon your death. Primary beneficiaries are typically your spouse, children, or other family members. If you have more than one primary, you should designate in your estate plan how the assets should be distributed among them.

If things don't work out with your primary beneficiary, your assets then go to your contingent (or secondary) beneficiaries. These are the people second in line to receive your assets and can be anyone you want - your children, other family members, a non-profit organization, etc.

Other items in your estate plan should include your will, trusts, letter of intent, and powers of attorney.

Strategy 10: Consider Talking with a Fiduciary Financial Advisor

Having a large sum of cash is a perfect opportunity to look into a fiduciary financial advisor.

Financial advisors come in many forms, such as fiduciaries and brokers, and can follow different forms of conduct, such as the Fiduciary Standard and the Suitability Standard.

A fiduciary financial advisor follows the Fiduciary Standard - meaning they are legally required to put your financial interests ahead of their own. A fiduciary advisor is free from conflicts of interest, and fiduciaries cannot receive commissions - they can only receive fee-based compensation.

In contrast, brokers follow the Suitability Standard instead of the Fiduciary Standard, which means they ensure their recommendations are only *suitable* for the client according to their age and goals. Brokers also receive commissions on their recommendations, which can cause conflicts of interest to impact your investments.

A Google search for "fiduciary" or "fee-only" advisors will pull up advisors near you who follow the Fiduciary Standard. And if you're ever wondering if an advisor follows the fiduciary standard, ask!

Special Offer from Chicago Partners

We've given you a lot to think about in this guide, and you might be wondering "Where do I start with all of this?"

We've got you covered! Right now, Chicago Partners Wealth Advisors is offering a complimentary Portfolio X-Ray to give you a sense of what the right investment portfolio would look like for you. To redeem this offer, feel free to reach out to us by using the Contact Form on our website. Make sure to mention that you've read this whitepaper, and an advisor will reach out to you shortly with more information on how to complete your Portfolio X-Ray.

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