

My plan for \$63,000 in Cold Hard Cash

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It's no national secret that my investment accounts are largely flush with cold hard cash. As I write this post my brokerage accounts have a total net liquidation value of \$102,000 (rounded number). Of the total liquidation value I have \$39,000 invested, with the remaining \$63,000 sitting in cash. Most of the personal finance bloggers out there would likely advise me to continue putting money to work regardless of the fact the stock market is at ALL TIME HIGHS.

However, I have a much different philosophy. I agree that the market has had an incredible run over the last 6+ years. The market has more than tripled since its 2009 low of 666. With a high of 2118 from February, this translates into approximately a 21% compounded growth rate over the 6 year period. That is an incredible and very impressive run. It's true that the markets tend to over correct on both the upside and the downside. So it should not be much of a surprise that we have experienced such large gains these past 6 years (compared to the historical average of about 8%).



(By the way, when I refer to the “market,” I am talking about the S&P 500 as my benchmark. This index represents the 500 strongest companies in the United States and is typically the index most people are talking about when referring to “the market”).

I am by no means a technician but I do like looking at charts to get a visual of performance. Looking at the picture above, the trend is looking a bit parabolic and I think we can all agree that markets do not go up in a straight line.

My Investment Philosophy

A few months ago I started a series on [the 10 rules I live by](#) when it comes to investments (I haven’t done a good job detailing the rules beyond #1 yet, but I will, I promise). Rule #2 on the list says to “*sell into strength.*” This is hard for most people to do. It’s as equally hard as [Rule #1](#) that says to “*buy into weakness.*”

Many people didn’t buy at the 2009 bottom or as the market was falling because of the fear of loss. They had just seen their investments cut in half. Why would they

put more money at risk? The media scared them so much that many even sold their positions and took the loss. Or even if they held on they didn't have any money available to take advantage of low prices, because they were always told to be fully invested.

The sagest advice when it comes to investing is to "buy low and sell high." Everyone has heard this mantra, yet most people do the exact opposite. It's really easy to do once you realize how hard it is AND once you put rules in place to keep you honest.

Like *buying into weakness* (rule #1), *selling into strength* (rule #2) is equally as hard. And again, it stems back to fear. This time it is not the fear of loss, but the fear of missing out. Herd mentality kicks in and retail investors get burned. Think about it, the money managers out there have a vested interest in keeping you fully invested. They don't make money when you're not invested in their mutual fund that they get to charge you fees on.

So what do you do then?

You have to systematize your investing.

You need to create rules around how you operate.

You need to take the emotion out of the equation.

You need to make some common sense observations.

You need to have cash on hand to take advantage of opportunities (like market corrections that are guaranteed).

You need to be a little contrarian.

You need to ignore the news.

You need to start looking at investing as a pure numbers game.

You need to reject the herd mentality.

You need to be patient for opportunity.

I have been following my own rules over the past 6 months by “*selling into strength*” and raising cash for better prices that lie ahead. I don’t know when those better prices will come; all I know is that the only way I will take advantage of them is if I have the cash to do so. All of this money is in pre-tax accounts, so I don’t need to worry about tax consequences. Over the course of the last 6 months I have gone from being 80% invested to now only around 40% invested.

Now for the \$63,000 question

How do you know when to put your money back into the market?

It is the same question I struggle to answer on the upside. There is no crystal ball. I am not naive enough to think that I can time market tops and bottoms. But I have learned to pick my spots, but not through blind faith. I turn to the options market where probability gets assigned to different price levels.

Here is something I shared over on 1500days.com back on March 26, 2015. As I wrote it, the S&P 500 was at 2054. It is non-news related and all numbers:

1 - There is a 60% probability that the S&P 500 touches 1,850 by year end, which would represent about a 10% correction (or about 204 points) from the current reading above (and a 13% correction from all-time highs).

2 - There is a 35% probability that the S&P 500 touches 2,250 by year end, which would be about 9.5% higher (or about 196 points) than the current index reading above.

So the expected return if you are committing new capital looks like this:

Expected Return = (35% x 196) - (60% x 204) = 68.6 - 122.4 = -53.8

Expected ROI = (2054 - 53.8)/2054 - 1 = approx -2.6% (that’s a negative return)

I know my bank is only paying me 0.5% interest on my cash and making extra payments on my mortgage is saving me 3.675% interest. That sure seems like a better return than -2.6%...and that’s why I am not investing new capital at this time.

As you can see from the example above, the options market is pricing in a much higher probability that the market will trade down 10% vs. trading up 10%. I actually think that the probability is a bit higher than 60% that we will trade down by 10% by the end of the year. But I have no control over the probabilities; I can only make a plan based on the numbers.

My first target to deploy some cash will be at 10% off of all-time highs (current all-time high is 2,118). And I have a tiered approach to deploying the capital at various levels:

Tier 1 = 10% correction from all-time highs (1,906) = deploy 10% of cash

Tier 2 = 20% correction from all-time highs (1,694) = deploy 25% of cash

Tier 3 = 30% correction from all-time highs (1,482) = deploy 40% of cash

Tier 4 = 40% correction from all-time highs (1,270) = **ALL IN**, deploy remaining 25% of capital

This does not mean however that I will not deploy capital in other sectors that may be presenting opportunities to buy into weakness. A perfect example of this was oil and the related ETF's. I actually shared an example of how I took advantage of buying into weakness [here](#). It is a classic example of how years of growth can be decimated in months, presenting incredible risk/reward opportunities.

In the short-term I do risk underperforming the markets, but in the long-term I know that better prices lie ahead.

Unlike many, I don't have an issue of holding onto cash. I am not scared of inflation eating away at my purchasing power, nor am I in fear of missing out. It all comes back to numbers and common sense to me.

Here is a good analogy - think of market direction in terms of a baseball and gravity. Imagine you're given a baseball and asked to throw it straight up in the air as high as you can. However, before you do, you are offered the opportunity to bet how high you can throw the ball before it comes crashing down to earth due to gravitational forces as the energy you transferred to the ball fades.

You are given a sheet with different vertical distances and asked how much you are willing to bet at each distance. Let's say it looks something like this:

- 10 Feet
- 50 Feet
- 100 Feet
- 150 Feet
- 200 Feet
- 250 Feet
- 300 Feet
- 350 Feet
- 400 Feet
- 450 Feet
- 500 Feet

Now unless you have some super human strength I am willing to bet that your bet will get closer to zero the closer you get to 500 feet. Deep down you know that at some point the force of gravity is going to out power the force you applied to the ball when you threw it up in the air.

The markets work the same way. In market speak gravity is mean reversion.

Do you have a unique approach to the market? Or do you just follow the buy and hold philosophy?

- Gen Y Finance Guy

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Gen Y Finance Guy

Hey, I'm Dom - the man behind the cartoon. You'll notice that I sign off as "Gen Y Finance Guy" on all my posts, due to the fact that I write this blog anonymously (at least for now). I like to think of myself as the *Chief Freedom Officer* here of my little corner of the internet. In the real world, I'm a 30-something former C-Suite executive turned entrepreneur turned capital allocator. I am trying to humanize finance by sharing my own journey to Financial Freedom. I believe in total *honesty* and *transparency*. That is why before I ever started blogging, I decided that I would share all of my own [financial stats](#). I do this not to brag, but instead to inspire motivate, and also to hold myself accountable. My goal is to be a beacon of hope, motivation, and inspiration for *you*, the reader, by living life by example and sharing it **all** here on the blog. My sincere hope is that you will be able to learn from me - both from my successes and my failures! [Read More](#)