The Bucket List: Too much—or too little—liquidity?

By: Michael Liersch, Global Head of Wealth Planning & Advice

Many people say, “Cash is king.” But others say, “Cash is a drag.” Which is it? How do you know if you have too much or too little cash? And what should you do about it? One reason there are so many different views on cash is that access to cash goes well beyond deposits in a bank account for that unexpected expense or life event. It includes lines of credit, money market funds, short-duration fixed income and more. But how do you know the solutions are right for you based on what you’re trying to accomplish with your money?

When you assign your money (assets) to different buckets of wealth, it can help you organize—and utilize—your money in ways that support your intentions. So, let’s reframe the idea of cash: Intentionally create a “liquidity bucket” in your family’s financial life.

The purpose of the liquidity bucket is to give you access to money at all times for whatever reason, so that you have a foundation for financial solvency, health and confidence to address anything that comes your way. This bucket allows you to live your lifestyle without having to constantly monitor what money is coming in and what’s going out. It can help you feel psychologically safe and avoid selling investments at exactly the wrong time and give you the opportunity to buy at exactly the right time. Being able to easily draw on money can enable you to buy a big ticket item or address an unexpected large payment (e.g., taxes) without having to scramble.

In thinking about these aspects of liquidity, it’s helpful to have a framework. Here are four categories that you can use to identify your liquidity needs:

- Operating cash flow: How much do you need to cover essential and discretionary spending for one to five years?
- Psychological safety net: How much of a cushion do you need to sleep well at night?
- Opportunistic funds: How much do you want so you can make timely investments?
- Big ticket items: How much should you have on hand for the occasional major purchase?

Let’s take these one by one.

INVESTMENT AND INSURANCE PRODUCTS ARE:
• NOT FDIC INSURED • NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY • NOT A DEPOSIT OR OTHER OBLIGATION OF, OR GUARANTEED BY, JPMORGAN CHASE BANK, N.A. OR ANY OF ITS AFFILIATES • SUBJECT TO INVESTMENT RISKS, INCLUDING POSSIBLE LOSS OF THE PRINCIPAL AMOUNT INVESTED
Operating cash flow
Make an honest, accurate tally—deep breath now—of how much money is going out the door on an annual basis. Some of this is essential, some of it discretionary. What does it add up to? We advise clients to have enough money available to cover one to five years of spending needs.

Beware of what we call the “one-time, ongoing expense.” So, for example, clients tell us that they remodeled their home or purchased a new car—but these were a “one-time expense” that won’t happen again. Yet the following year, they have another major, unplanned expense. These repeated “one-off” expenses are more common than you think, and they’re fine—if they’re planned for.

It’s also important to be clear-eyed about what you mean by “discretionary.” If you’re emotionally attached to the family retreat and would be very unhappy to give it up, it doesn’t make sense to think of the real estate as a liquid asset. Better to call your second home an essential, non-discretionary expense and find other sources for needed liquidity. Operating cash flow is commonly staged in terms of money needed in the shorter term, which can be literal cash deposits in the bank. For more intermediate and longer periods, a variety of other strategies are typically used from money market funds to lines of credit to short-duration fixed income.

Psychological safety net
The second category of liquidity reserves is by definition a very personal choice. A psychological safety net lets you sleep well at night. Money can’t buy happiness but it can buy peace of mind. Be very deliberate when you think about the size of your safety net—be precise about your number. For some people—and I’d count myself in this group—having an ample cash cushion enables us to feel comfortable taking risk in the rest of our portfolio; it can help us stay invested even during turbulent markets so that we can achieve the long-term returns that investing can offer.

But it’s also important to be realistic. Because of inflation and its damaging effect on the value of cash over time, holding large amounts of cash may be detrimental to achieving desired future outcomes—even though the cash makes us feel safe in the present. This is where psychological safety and the reality of the goal attainment intersect. If holding large amounts of cash means we’re not invested as much (or as aggressively) as we need to be, that’s an issue we should address. It may involve tough trade-offs, whether that be sacrificing more discretionary goals or investing more aggressively.

Opportunistic funds
Think of opportunistic funds as “dry powder” set aside for timely investments. Come up with a framework for how quickly you’ll want to access this money. Many of our clients “stage” these reserves—with some funds accessible in, say, six months, 12 months and 18 months.

Opportunistic funds are often deployed in times of market volatility, as we’ve seen in recent months. Perhaps you spot a beaten-down stock or strategy that you believe offers good long-term value. You’ll likely need same-day liquidity to take advantage of such an opportunity. On the other hand, you might access your six to 12 months cash reserves to participate in an attractive private equity fund offering or a business venture.
**Big ticket items**

You want to be prepared to make a big ticket purchase of a tangible asset—but you want to do it sensibly. Say you find a piece of art you love. You might have the cash to buy it outright—but maybe that’s not the best approach. Instead, you may want to talk to an advisor who can help you make the purchase in the most efficient way, such as taking out a line of credit instead of dipping into your cash reserves.

When discussing purchases of tangible assets, we often remind clients of a principle known as the endowment effect. That is, we tend to place a higher value on things we own, or even imagine owning. We can’t nullify the endowment effect—it’s how we humans are hardwired—but we can keep it in mind when making a big ticket purchase. You may be prepared to pay up for your dream house, but is it worth paying twice its market value?

**Final thoughts**

As you consider how much liquidity or cash you need on hand, be specific about what exactly it is you’d like to do with it. Here’s an example of how you can align capital from your overall portfolio into a liquidity bucket (see Aligning capital to your liquidity bucket).

<table>
<thead>
<tr>
<th>Category</th>
<th>Capital needed</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating cash flow</strong></td>
<td></td>
</tr>
<tr>
<td>Lifestyle spending at $250K annually</td>
<td>$250K</td>
</tr>
<tr>
<td><strong>Psychological safety</strong></td>
<td></td>
</tr>
<tr>
<td>Money for peace of mind</td>
<td>$50K</td>
</tr>
<tr>
<td><strong>Opportunistic funds</strong></td>
<td></td>
</tr>
<tr>
<td>Dry powder for timely investments</td>
<td>$100K</td>
</tr>
<tr>
<td><strong>Big ticket items</strong></td>
<td></td>
</tr>
<tr>
<td>Car purchase and home remodel</td>
<td>$100K</td>
</tr>
<tr>
<td><strong>Total liquidity bucket</strong></td>
<td>$500K</td>
</tr>
</tbody>
</table>

When allocating assets to your buckets, remember to keep your overall goals in mind. Do you have too much or too little in liquidity reserves? There’s no “correct” amount. The important thing is to think clearly—and with deliberate intent—to find the solution that’s right for you. We believe our four-element framework can be helpful in framing your thinking, and guiding your conversations with your J.P. Morgan Advisor.
The information expressed is being provided for informational and educational purposes only. Opinions expressed herein are those of the author and may differ from those of other J.P. Morgan employees and affiliates. It is not intended to provide specific advice or recommendations for any individual. You should carefully consider your needs and objectives before making any decisions.

Investment products and services are offered through J.P. Morgan Securities LLC (JPMS), a registered broker-dealer and investment advisor, member of FINRA and SIPC. Annuities are made available through Chase Insurance Agency, Inc. (CIA), a licensed insurance agency, doing business as Chase Insurance Agency Services, Inc. in Florida. JPMS, CIA and JPMorgan Chase Bank, N.A. are affiliated companies under the common control of JPMorgan Chase & Co. Products not available in all states.