

When “Cash” Isn’t Cash

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According to the Federal Reserve, nonfinancial companies had \$1.84 trillion in cash and other liquid assets as of the end of March—up 26% from a year earlier. Cash made up about 7% of all company assets, the highest level since 1963. What will companies do with all this cash?

When you hear the word “cash,” you probably think of those green notes in your wallet. But what businesses have a lot of is not that kind of cash, but rather, cash equivalents. Instead of sitting on mounds of dollar bills, they have large balances of short-term, liquid assets such as

Treasury bills or commercial paper.

The Important Difference between Cash and Cash Equivalents

The distinction between “cash” and these “cash equivalents” is incredibly important. If companies were sitting on cash, the result would be a big economic drag, fueling deflation. Cash was meant to be circulated, and if it doesn’t circulate, it doesn’t do much good. Today’s businesses have distributed their cash by purchasing short-term debt to fund our government’s budget deficit, along with satisfying short-term funding needs of businesses and consumers. In these ways, corporate savings have funded public borrowing. Instead of dragging the economy down, these reserves have supported it.

A Hoarding Mentality in Business Today

Hoarding cash equivalents seems like a reasonable thing to do in today’s business environment. If you receive a windfall of money, you might spend a good chunk of it, but you might also like to spread your spending out over time. If you think that the windfall was a one-off event, not likely to be repeated, then you might save an even larger portion of that windfall to make it last longer. I think businesses are doing just this: they generated some cash, and since they don’t know if they can make more any time soon, they have decided to conserve, instead of spending it. I think businesses today are more inclined to buy another business that has strong cash flows than to pay out special dividends or commit their money to an irreversible investment in their own business.

Corporate Spending Outlook

Considering the high likelihood of increased operating costs in the future, especially for businesses with large numbers of employees, the most attractive targets are those with high cash flows relative to the number of employees. I believe this favors stocks in the manufacturing and information technology sectors.

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