The Psychology of Sitting in Cash

A reader asks:

I took one piece of advice from a close friend that the market was too high and that I should go to cash and wait for a correction. I am still waiting. How do I proceed from the position I have of feet embedded in concrete?

Since I started this website, this is by far the most asked question I get from readers, which is unfortunate given the steady rise in the markets. This reader shared with me he's been in cash for a number of years now and doesn't know how to proceed.

The problem is not just sitting in cash per say. It's really the mind-games that come about as a result of making a binary decision to go all-in or all-out. Tadas Viskanta from Abnormal Returns put it best when he once wrote:

Market timing is a gateway to cash addiction.

And that's one of the biggest issues when you pull the trigger and go to all cash. It turns psychological warfare in your own head because there are always going to be good reasons to wait for a better buying opportunity. When stocks go up, you tell yourself you'll wait for a correction and when stocks fall, you tell yourself you'll wait for them to drop just a little further.

It's easy to look back on it now and say how much of a lay-up it was to invest at the depths of the market crash in early 2009, but there weren't too many people saying things were all clear at the time. Investors were scared and constantly waiting for the next shoe to drop. Ever since the recovery started people have been doubting it's legitimacy. Pundits have been scaring people away with predictions of double dip recessions, hyperinflation and the collapse of the U.S. dollar.

Don't let anyone tell you investing in this bull market has been easy. It hasn't, but really, it never is.

When thinking about what those sitting on a pile of cash should do now, I could write about the length of the bull market in stocks or level of bond interest rates. But really this question has nothing to do with the financial markets and everything to do with human psychology.

I had another reader tell me he's been in cash since 1999 -- fifteen years of inaction. After seeing the aftermath of the tech bubble he couldn't pull the trigger and get back into the market. Then the Great Recession shook his confidence in the markets even further. I asked this investor if he could explain to me why he thinks it was so hard to get back in. Here were his reasons:

1] fear
2] arrogance on my part thinking I can manage our funds as well as a RIA without incurring the

costs,
3] and a loss of confidence in most all asset classes, most especially with our government's meddling.

Both of these readers told me that they had rules in place based on technicals or moving averages that would give them a signal that would tell them when to get back into the market. But when those thresholds were hit, the fear of coming off the sidelines was too much to handle. Here's what this same reader had to say about what he's learned from sitting in cash for so long:

So I am living proof that the challenge in timing the market is being right both getting out and going back in... PLUS having the courage and confidence to take action.

When readers ask me what they should do when they're in this position I can never fully answer their question because everyone's situation and risk tolerance is different. My response is always that whatever you choose to do -- dollar cost average over time, wait for a market correction, put it all back in at once, hire a professional -- try to have a plan of attack that you can follow. It's no good to create a plan that you have no chance of actually seeing through because you become paralyzed by fear or greed.

This dilemma has nothing to do with cash as an investment option. Or the current stock market valuations. Or the opportunities cash can bring about in a market crash or correction. Those things *can* be important to understand, but they don't really matter if thinking about them causes you mental anguish and leaves your feet stuck in the concrete. It's about having the ability to get over the fear of allowing market forces stop you from implementing an investment plan.

Sources:
[Cash is a bad habit most investors need to kick (Abnormal Returns)]

Further Reading:
[The Problem With Intuitive Investing]