Planning Research Note

THE THREE PILLARS OF CASH

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clarity

SUMMARY

Although by no means the most exciting aspect of good money management, **cash is the bedrock of effective strategic financial planning**.

Most people have an instinct to maintain an element of cash to protect against unknown scenarios - and periods of extreme market volatility and financial uncertainty. However, often little thought or ‘maths’ is applied when determining the level of cash reserves that are needed for **your specific circumstances**.

It is, of course, crucial to maintain healthy liquidity to protect against having to force sell investments when markets dip. However, it is equally important not to be too ‘cash heavy’ and miss out on growth opportunities.

So, how do you quantify the amount of cash you need? Rather than just ‘pick a number that feels right’, we apply a bit of ‘maths and science’ based on the **three pillars of cash: emergency, income and capital**.

PILLAR 1: EMERGENCY

ENSURING YOU HAVE AN ADEQUATE EMERGENCY CASH FUND IS THE FIRST STEP IN GOOD FINANCIAL PLANNING.

We typically recommend that, as a minimum, this needs to be equal to the higher of:

1. Six months expenditure.
2. Your emotional level.

When talking about your emotional level of cash, this is the minimum amount you need in order to simply feel comfortable. In many ways, the science becomes irrelevant at this point, as your peace of mind predominates. When planning as a couple, if you and your partner have different emotional levels, then go with the higher figure of the two. This ensures you are both comfortable. Peace of mind is, after all, one of the key reasons for creating and following a strategic financial plan.

PILLAR 2: INCOME

ONCE YOU HAVE AN APPROPRIATE EMERGENCY FUND, YOU NEED TO CONSIDER PILLAR 2, INCOME.

For many people, income requirements vary from year to year as circumstances change. If, **over the next three to five years**, you anticipate that your 'normal' expenditure will exceed your net income, then you will need to plug this gap – or draw from your investment reserves.

As highlighted above, the forced sale of investments at inappropriate times can be very costly. **If you plan your income requirements in advance, then you can hold the necessary level in cash or 'near cash' so it, too, is available when needed**.

This type of income deficit often comes about in retirement, when you are relying on your pension funds and investments, rather than earnings, for income. However, an income deficit can also occur temporarily during your working life, particularly if you are self-employed or supporting children with school or university costs.

PILLAR 3: CAPITAL

FINALLY, WE HAVE PILLAR 3, CAPITAL.

Perhaps you are moving house soon or expect to help other family members with deposits? Maybe you have some significant maintenance costs anticipated on your principal residence or holiday home, or you are expecting a large tax bill?

Any capital spend planned in the near future should be considered and included in your final cash (or 'near cash') figure. Again, this avoids the need to force sell investments at short notice, potentially crystallising market losses when you do so.

CASH PLANNING AND MANAGEMENT

clarity clients benefit from use of our **WealthPlan** to help forecast, model and control their cash requirements. WealthPlan is a cash-flow and income forecasting tool, which we developed inhouse, enabling you to consider the financial impact of various scenarios and segment your financial plans into different priorities.

In addition, when holding relatively large levels of cash, you ideally want to achieve some level of return to mitigate some of the impact of inflation, but whilst being mindful of security and FSCS protection levels. To address this issue, we have partnered with **Insignis**, the specialist active cash management provider. This service helps you get the best interest rates for your cash, and benefit from the maximum level of FSCS protection across different banking licenses, without the hassle involved in setting up multiple accounts yourself. In addition, you can allocate different levels of cash to accounts targeting varying timeframes – from instant access to five-year fixed term, and various other timeframes in between – to further enhance returns.

FIND OUT MORE

For more information on our strategic financial planning services, WealthPlan or active cash management service, please contact your usual clarity adviser. Alternatively, you can get in touch on:

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