# Cash & Cash Equivalents

BEGINNER LESSON EXPLAINER

## What Counts as “Cash” in a Portfolio?

Cash and cash equivalents are the most liquid, lowest-risk layer of investing — physical cash, checking and savings accounts, money market funds, and short-term Treasury bills (maturing in a year or less). Unlike stocks or bonds, their nominal value essentially never drops: $1,000 in a savings account is still $1,000 tomorrow. But that stability comes at a cost — cash typically earns the lowest return of any major asset class, and if it earns less than inflation, it's quietly losing real value even while the number on the statement stays the same or grows a little.

A useful analogy: think of cash like keeping food in the fridge instead of the freezer. It's instantly accessible whenever you need it — no waiting, no risk of a bad thaw — but leave it there too long and it slowly spoils anyway. Cash doesn't “spoil” in the sense that the dollar amount ever falls, but its buying power quietly does, one percent of inflation at a time.

## Real Example: The 2022 Cash Squeeze

2022 is the clearest recent illustration of cash's real enemy. U.S. inflation peaked at 9.1% that June — while the average bank savings account was still paying almost nothing.

| | |
|---|---|
| National average savings APY, 2022 | **~0.06%** |
| U.S. inflation peak, June 2022 | **9.1%** |
| 13-week Treasury bill yield, end of 2022 | **~4.0%** |

A typical savings account lost roughly 9 percentage points of real purchasing power that year alone, despite the balance never falling. Treasury bills and money market funds — which track short-term interest rates much more closely — climbed from near 0% in early 2022 to nearly 4% by year-end, still short of inflation but a very different outcome from a standard savings account.

## Real Example: What $10,000 in a 0% Account Actually Loses

Same $10,000, same 10 years, same 3% average inflation — the only difference is where the cash sits.

| | 0% checking account | ~3.7% T-bill / money market |
|---|---:|---:|
| **Nominal balance after 10 yrs** | $10,000 | $14,381 |
| **Interest earned** | $0 | $4,381 |
| **Real purchasing power** | $7,441 | $10,701 |

The checking-account balance never dropped below $10,000 — yet it can only actually buy what $7,441 buys today, a real loss of $2,559. Meanwhile the money-market-style account not only nominally grew to $14,381, its real purchasing power still came out ahead too, at $10,701. The balance on the screen isn't the whole story — what it can actually buy is.

## 5 Things to Know About Cash & Cash Equivalents

**1.** FDIC insurance covers up to $250,000 per depositor, per bank — your bank deposits are protected up to that limit.

**2.** Not all “cash” pays the same — national average savings rates can be a fraction of what a high-yield savings account or money market fund pays for similar safety.

**3.** Cash's real enemy isn't a market crash — it's inflation, which erodes purchasing power every year, even while the balance never falls.

**4.** Money market funds aren't FDIC-insured like a bank account, though they're generally considered very low risk.

**5.** Cash isn't meant to grow your wealth — its job is safety, liquidity, and a place to hold money you'll need soon.

## 4 Things to Check on Your Cash

**Compare Your Actual APY.** Many big banks still pay near-0% on standard savings accounts. A high-yield savings account or money market fund can pay meaningfully more for similar FDIC-style protection.

**Match Cash to Your Time Horizon.** Money you need within a year or two belongs in cash, not markets, regardless of the return gap — a downturn right when you need the money is a real risk stocks carry that cash doesn't.

**Check It's Keeping Pace With Inflation.** A “safe” 0.5% APY during 4% inflation is still losing you money in real terms every year. “Risk-free” and “loss-free” are not the same thing.

**Keep an Emergency Fund Separate.** A common rule of thumb is 3-6 months of expenses held in accessible cash before investing further, so a market downturn never forces you to sell stocks at a bad time.

**Worth knowing:** “safe” and “risk-free” aren't quite the same thing — cash protects you from market volatility, but not from inflation eroding its buying power over time. National average savings rates and money market/T-bill yields shown here are illustrative snapshots and change constantly with interest rate policy — check current rates before making a decision.

## Quick Check: 5 Questions

Answer all five before turning the page to check yourself against the answer key.

**1. What's the main trade-off of holding money in cash and cash equivalents?**

- A. Higher returns than stocks, with no risk
- B. Very low risk and high liquidity, but typically the lowest returns of any major asset class
- C. Guaranteed to beat inflation every year
- D. No FDIC protection at all

**2. In 2022, the national average savings account paid about 0.06% APY while U.S. inflation peaked at 9.1%. What does this illustrate?**

- A. Cash sitting in a low-yield account can lose significant real purchasing power even though the balance never drops
- B. Savings accounts are FDIC-insured against inflation
- C. Money market funds and savings accounts always pay the same rate
- D. Inflation only affects stocks, not cash

**3. What does FDIC insurance actually protect against?**

- A. Inflation eroding your account's purchasing power
- B. Stock market crashes
- C. Your bank failing, up to $250,000 per depositor per bank
- D. Interest rate changes

**4. Why might a 13-week Treasury bill or money market fund pay a different rate than a standard bank savings account?**

- A. They are exactly the same product, just with different names
- B. T-bills are much riskier than savings accounts by design
- C. They can't be used for a similar purpose
- D. T-bills and money market funds often track short-term interest rates more closely, while many bank savings accounts lag behind

**5. What's a common rule of thumb for how much to hold in an accessible emergency cash fund?**

- A. None — invest everything in stocks
- B. 3-6 months of living expenses
- C. Exactly one paycheck
- D. 50% of your entire net worth

## Quiz Answer Key

**1 B** — Cash is about safety and accessibility, not growth — it typically earns less than stocks or bonds over time, in exchange for near-zero volatility and instant access.

**2 A** — The account balance never fell, but with prices rising 9.1% while the account paid essentially nothing, that same balance could buy meaningfully less by the end of the year — a real, silent loss.

**3 C** — FDIC insurance protects your deposits if your bank itself fails, up to $250,000 per depositor per bank — it does nothing to protect against inflation quietly eroding what that money can buy.

**4 D** — Banks can be slow to pass on higher interest rates to savers, while T-bill and money-market yields move much more directly with short-term rates — which is exactly what happened through 2022.

**5 B** — 3-6 months of expenses is a widely used starting point — enough to cover a real disruption without forcing you to sell investments at a bad time.