# Retirement News Highlights

*Tuesday, July 19, 2022*

## Copious Corporate Cash May Not Be So Great, After All

**Touted as a bulwark against recession, it could draw down quickly—and it is concentrated at a few big companies.**

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July 19, 2022

U.S. corporate books are awash in cash, which some say should insulate them in an economic downturn—and potentially keep their stock prices higher when others are tanking. Cash "is incredibly useful when it comes to weathering uncertainty—something the global economy has experienced a lot of recently," notes a recent study from the Kellogg School of Management at Northwestern University.

Nonetheless, the voluminous cash caches may be transitory. The biggest cash holdings are concentrated at major companies, and many others still have poor cash positions. As a result, cash stashes have declined recently as less well-heeled businesses draw them down. Beyond that, a prolonged recession could diminish even the fattest cash accounts.

In broad scope, corporate America's flush cash condition leaves it "much better able to withstand financial stress than" during the 2008 and 2009 financial crisis, "and reduces the probability of a credit recession," says Andrew Palmer, CIO of the Maryland State Retirement and Pension System, whose staff has studied the phenomenon. The weakness: "Despite the stronger balance sheets, I don't believe companies are immune to a significant systemic shock."

Balance sheets "deteriorated quickly" during the early part of the pandemic, Palmer notes. Then came torrential fiscal and monetary stimulus, which restored them—although some sectors, particularly airlines and cruise operators, "remain highly levered, and so are susceptible to demand shocks in those industries."

Conventional wisdom, to be sure, is that a recession is coming. Revenue will fall while higher wages and other costs will bedevil companies, and that "will put pressure on profit margins," predicts Matt Lloyd, chief strategist at Advisors Asset Management. Hence, more and more corporate officers will need to tap cash.

At year-end 2021, nonfinancial companies had $6.5 trillion on their books, but after this year's first quarter, that had shrunk to $4.5 trillion, according to Toggle, the artificial intelligence research firm. "Smaller companies are using the money to stay afloat," says Giuseppe Sette, Toggle's president and co-founder. "This will serve us well for a few quarters," but he questions how long the benefit will last after that.

### Cash Inequality

Just 10% of investment-grade companies have almost two-thirds of the cash, by the count of the research organization Alpine Macro. “These savings are not evenly distributed,” observes Crit Thomas, global market strategist at Touchstone Investments, in reference to the cash build-ups. “The wealthier companies don’t need” the money, and the less well-fixed do.

An example of this yin-yang situation is Peloton Interactive, the darling of the pandemic’s stay-at-home period. The exercise equipment maker allows people to work out on the company’s bikes and treadmills at home, taking classes via an online link.

Revenue doubled between 2020 and 2021, but lately it has dropped off. The company’s losses—it has been in the red for a long time—have deepened. This has prompted Peloton to shed employees, make plans to outsource manufacturing and do other belt-tightening.

Meanwhile, it is rapidly depleting its cash to operate the business. Unsold equipment is mounting up in their warehouses. In an analysts’ call for the most recent quarter, new CEO Barry McCarthy said, “We have too much for the current run rate of the business, and that inventory has consumed an enormous amount of cash.”

The cash on hand as of the March-ending quarter was $879 million, almost half of its level the year before. And the 2021 cash was on the skimpy side to begin with. While it hasn’t carried a crushing debt load, it was forced to borrow $750 million from Goldman Sachs and JPMorgan to plug fresh dollars into its anemic cash drawer.

Even worse off, warns Andre Perold, CIO of HighVista Strategies, are many biotech firms. They will be in trouble because they as yet have no revenue coming in, he says. A lot of their resources are aimed at research and development, with the hope that they will come up with a revolutionary product that will vault them into the black. Right now, though, “they are burning through their cash,” he says.

The problem with revenue-free biotechs is that turning to lenders or capital markets is difficult. The best they can do is plead for more venture capital investments. At least Peloton has the receipts to justify its going to JPM and Goldman, and go more heavily into debt. “As long as you make money, you can raise money,” Perold says.

On the other end of this continuum are the large companies that have vast amounts of cash and are performing just fine in terms of profitability. Nancy Tengler, CEO and CIO of Laffer Tengler Investments, advises her clients, many of them institutions, to “focus on companies with a lot of cash.” These turn out to be heavyweights on the order of Apple (cash: $7.6 billion), Microsoft ($105 billion) and Johnson & Johnson ($30 billion). This bounty enables the companies to do stock buybacks, maintain dividends and acquire other businesses with ease.

For these big kahunas, the ample cash is a nice extra. “Apple doesn’t have to make economic decisions based on cash,” says Toggle’s Sette. “They can do it out of earnings.” And if the economy really goes south? “The large guys will acquire distressed companies,” he says. Because they can.

## The Debt Factor

Handling debt is the premier use of cash for companies. Overweening debt was the catalyst for the 2008 and 2009 financial crisis, but since then the world—governments, households and companies—actually have increased their leverage. In 2008, corporate nonfinancial debt made up 41% of the world’s gross domestic product, per a study from the McKinsey Global Institute. By 2017, that had expanded to 66%, and there’s no sign it has decreased in the interim.

That is the result of the extremely low interest rates after the crisis, McKinsey says. Leveraged loans, which are bank loans given to junk-rated companies, tend to have floating rates, so they will track the new levels closely.

Won’t this prove to be a millstone for companies now that rates are going higher? Here, at least, is some partial good news. Certainly, a lot of pain is expected, with job losses, defaults and the like. But a large chunk of debt won’t mature for several years from now. That allows for some breathing room, except for leveraged loan borrowers.

The chief reason is that debt issuance has dropped. By year-end, it likely will be a third lower than in 2021, says S&P Global. How come? Unsettled macroeconomic conditions: the ongoing pandemic, high inflation, China’s shutdown, the war in Ukraine. “Companies are boarding up the stalls,” says Hans Olsen, CIO of Fiduciary Trust. Private equity firms, for instance, “need to husband their cash” and thus aren’t as eager to turn to debt markets, he finds.

Investment-grade companies, thanks to the sales boost from spent federal stimulus money, were able to pay down debt in some cases and “are starting this downturn in a strong position,” says Matt Daley, Conning’s head of corporate and municipal teams. Even high-yield companies “cleaned up,” he recounts.

When interest rates were near zero, a popular phrase was “cash is trash.” Higher rates will make cash more palatable. And the comfort lots of cash brings going forward in these dark times is, for those who have it, hard to deny. For those who don’t, condolences.

Back to top