TREASURY TRENDS

August 2018 | www.bancorptreasury.com | www.barringtontreasury.com **Issue 419**

Investing Cash: Do You Walk the Line?

The phrase *"walk the line"* invokes a sense of needing to finely balance competing objectives and forces, something with which all treasury managers are familiar, as well as the sound of a certain American singer.

To most organisations, cash management is about optimising cashflows to reduce debt and funding costs. However, there are many for whom cash management is about maximising surplus funds, which raises a completely different set of policies, objectives, choices, and disciplines involving the investment of cash. The critical question when investing cash is: what do the desirable features of maximised surplus cash look like?

Cash is always going to struggle to be the exciting investment choice, so it can often sit idle or off the radar. This can have all sorts of concerning consequences, such as thinking an investment is safe by keeping all cash holdings with a single bank.

Another possibility is falling for 'bait and switch' tactics whereby banks and fund managers attract new business with a teaser rate or return, and then penalise loyal clients by reducing their interest rates over time. This is a problem that is made worse with less transparent pricing, or where the terms on the cash account are linked to other services being delivered in a bundle.

Return on cash, or return of cash?

When it comes to investing surplus cash, every organisation should be virtually certain of being repaid all of its money, when needed, and in the desired form, which requires managing the credit or counterparty risk just as the bank does before it lends money. This can be achieved through a mix of:

- being in effect the lowest risk or 'most senior' lender should the unthinkable happen
- lending only to credit worthy borrowers, e.g., banks and governments
- ensuring that you lend to a diversification of borrowers, where available cash to invest allows
- thinking about the economic risks associated with the major sectors to which the borrower itself is exposed, again where available cash to invest allows.

It is important for cash investments to have excellent liquidity. Liquidity is the ability to get money back in no more than say two working days and with at most a very small loss of capital in all but the most extreme scenarios.

Even the humble term deposit often struggles to meet this requirement, with banks increasingly reluctant or unwilling to break the term early, at least not without penalty or notice period.

This underlines the importance of the positive returns and benefits that cash can provide during shocks to other asset classes and the essential role of cash in providing a rapid return of capital when other opportunities present themselves or unexpected cashflow requirements arise.

Know your investment vehicle

Assessing the creditworthiness of the borrower includes consideration of what the borrower will do with your cash. Will the borrower invest in longer term (illiquid) assets that could compromise your desire for liquidity? Do the borrower's environmental, social, and governance requirements match or conflict with your requirements?

The administration and governance required to manage cash investments should be fairly modest, so resources can be applied to other parts of treasury risk management, the business, and the broader investment portfolio.

Once the above conditions have been met, it is time to consider how to maximise the amount of interest you are being paid. In both New Zealand and Australia, non taxable investors should be able to get a positive interest rate, net of fees and inflation.

The amount of interest received can be materially improved by choosing a judicious mix of interest bearing bank accounts, as well as an appropriate term deposit strategy.

An alternative is securities that actually get put into so called *"cash"* and *"enhanced cash"* managed funds. These funds can certainly make the administration side of things easier, improve returns, and maintain excellent levels of

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liquidity. However, returns can only be improved by doing one or more of the following, most of which increase the risk profile:

- opting for a fund that charges less
- focussing on investing in securities with maturities in greater demand by borrowers
- investing more in fewer higher paying securities, which clearly increases credit risk
- investing in higher yielding securities with terms perhaps longer than preferable for a cash fund, which increases repayment risk — both in terms of timing of repayment and amount of repayment
- taking on more credit risk by changing the mix of investments.

The latter is quite topical in Australia currently, with regulators and a Royal Commission finding that cash investments have been marketed as *"cash"* but may contain holdings such as private loans and complex financial instruments, such as asset backed securities, both of which fail most of the desirable features of a liquid cash investment.

Under what circumstances is your cash investment liquid?

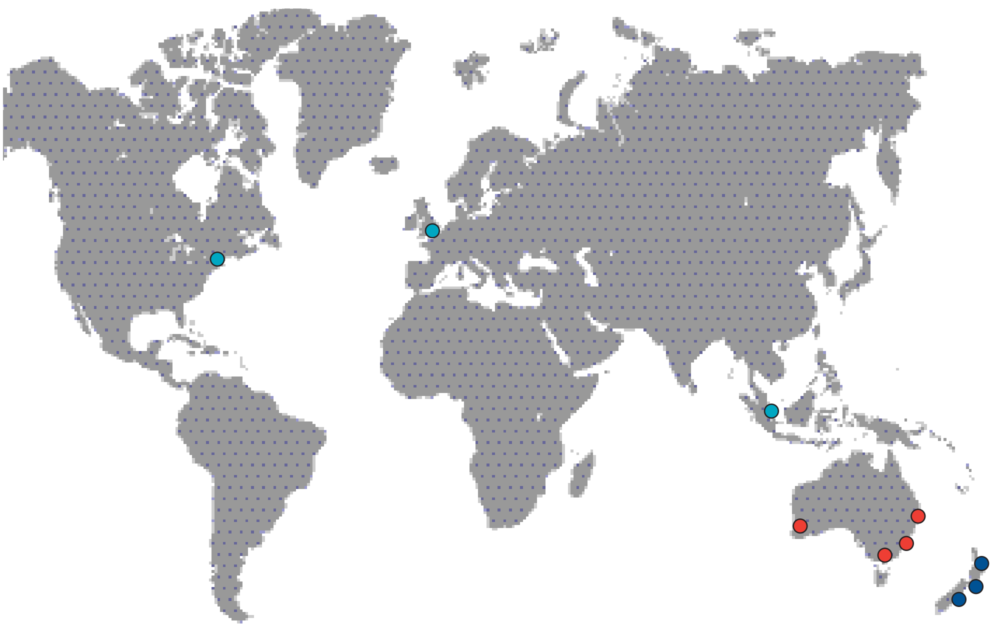
This depends on its terms, the financial strength of the borrower as well as the investment vehicle chosen. Many investment solutions proved far from liquid during the Global Financial Crisis, for example.

There is a place for bank term deposits in the liquid cash portfolio. With term deposits, investors give up some liquidity in exchange for higher returns, making term deposits excellent solutions for known short to medium term liabilities and cashflow requirements. Platforms are now emerging to make the interest rate discovery and administration parts of this process easier than in the past.

All the above sounds simple and obvious, yet many organisations are still failing to optimise cash resources, resulting in poor liquidity, sub-optimal returns or, at worst, loss of capital through poor credit assessment. As the song says, for me to *"walk the line"*, *"I keep my eyes wide open all the time."*

Bottom line: Are you and your Board/Council comfortable where you hold your cash? And how? Johnny Cash is one of the best-selling music artists of all time but perhaps his name encouraged him to leave us with some wise words around the basics of treasury management too.

WHERE WE AND OUR PARTNERS OPERATE



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