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Guide to active cash management

Avoiding the risks of hidden, unproductive or idle cash

Macquarie Group Limited

With the cash rate at its highest in over a decade and ongoing investor uncertainty about financial markets, the focus on cash allocations is growing. Given the higher yields now available, there could be an opportunity cost to holding idle cash.

The opportunity cost of idle cash

For advisers, now is the time to actively manage cash allocations. The cash rate has been at its highest in over 10 years, and yield curves are relatively flat, which means there is currently little premium for taking a longer-term risk on bonds.

With a holistic view of each client's cash requirements and holdings, you can see opportunities to optimise client returns, and in turn, share insights to strengthen relationships.

"Cash and fixed income investments are the ballast in a diversified portfolio," says David Carruthers, investment strategist in Macquarie's Banking and Financial Services group. Cash can help reduce the impact of market volatility and protect against losses. It also provides essential liquidity.

In the current market, idle cash could be missing out on greater returns—or delaying clients from achieving their wealth goals.

"Indications are that we are at, or close to, the peak of interest rates. Whilst many global central banks have already started to reduce cash rates, Australia may be delayed a touch longer due to a more stubborn inflationary backdrop," says Carruthers. "The RBA remains vigilant to any more upside surprises on inflation and can afford to wait until February 2025 to lower the cash rate ultimately."

Cash has always played a critical role in a diversified investment portfolio. In times of uncertainty, investors see cash as protection against risk—yet they may not perceive cash as an asset requiring advice.

This paper explores the cash opportunity to help advisers have meaningful conversations about cash management with clients and make the case for greater visibility of their total cash holdings.

Defining active cash management

There continues to be a heightened sense of uncertainty about the economic environment, along with uncertainty over when cash may be needed—even among high-net-worth investors. You need to get the balance right just as you would with any part of an investment portfolio, it is important to rethink what is locked away at a higher rate, and what might be needed for short-term payments.

Broadly speaking, we can establish a framework with three types of cash.

1. Transactional cash

Cash on hand to meet day-to-day expenses, typically across a six-month horizon. Given the impact of inflation on the cost of living, now is the time to revisit client budgets. Are they still realistic? Could that cash at call be earning more in a high-interest account?

2. Medium-term cash
When you know the timing of a capital call or are preparing for an investment opportunity, you can afford to put cash in a term deposit. This tends to be a 6-to-12-month view of cash requirements and can also be seen as a safety net.

3. Strategic cash
Strategic cash allocations seek to maximise returns for longer time frames, typically with a trade-off for liquidity. Until recently, the role of cash as a defensive play had been diluted by the lack of return. In the current market, there are opportunities for stronger returns without taking undue risks.

"Keeping track of cash flow and leaving a sufficient balance will help avoid the need to sell an asset at the wrong time or call on a term deposit before maturity," says Will Moloney, senior technical services manager. "A client's cash flow requirements may change from year to year, so engaging your client in that discussion will assist in meeting their needs," he explains. That is why it has never been more important for advisers to have visibility across all cash holdings.

How is the appetite for cash changing?

Since 2020, investors have shown an increasing preference for stability. According to a 2023 study published by the Australian Securities Exchange, *the 2023 ASX Investor Study*, 67% of investors say they prefer stable or guaranteed returns.

Self-managed super funds (SMSFs) are even more inclined towards capital preservation and income generation. On average, 22% of SMSF assets are allocated to cash—across transaction accounts, cash management accounts (CMAs) and term deposits. The proportion of SMSFs holding money in CMAs has surged in the past year, and 33% of SMSFs intentionally increased cash allocations in 2023[1]. Cash is also popular among high-net-worth investors, with 40% of Australia's private banking clients allocating funds to cash or cash equivalents and 37% investing in money markets, fixed interest and bonds.[2] But not all cash is 'zero-risk' cash. Only deposits with authorised deposit-taking institutions (ADIs) and up to a limit of $250,000 per account holder per ADI, are government-guaranteed by the Financial Claims Scheme (FCS).

When rates were close to zero, investors chasing higher yields found themselves moving further up the risk spectrum into cash-equivalent investments—at a liquidity cost. Cash equivalents include term deposits and investments which are defined by APRA as "short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value".

However, other income-producing assets—such as corporate bonds or residential mortgage-backed securities—do not meet the definition of cash. While Australian hybrid security holders are typically protected from the collapse of these assets, it is a timely reminder of the risk of chasing yield.

Weighing up cash options

Bank accounts—transaction or savings accounts that pay interest regularly and provide unrestricted access to funds. This convenience can come at a cost—once inflation is factored in, the real return on at-call cash could be negative. There is also a concentration risk involved in holding large amounts of cash with a single ADI.

Cash management accounts (CMAs)—as a cash investment hub, a CMA provides the benefits of a transaction account with greater visibility and control for advisers. Some, like Macquarie's Cash Management Accelerator Account linked to a CMA, may offer higher interest rates than an everyday bank account. They may compare favourably with a term deposit without sacrificing liquidity.

Term deposits—with a fixed rate of return, investors often see term deposits as a disciplined way to save money. Terms can range between one month and five years, and if funds are accessed early there may be a 'penalty' in the form of lost interest or a break fee. Term deposits with an ADI are eligible for the $250,000 per client government guarantee.

Cash alternatives—some managed funds could be considered as 'true-to-label' cash, and can act as a cash alternative in a portfolio. Some for example may offer an actively managed transactional cash solution providing exposure to a portfolio of cash and short-term fixed-interest securities issued by government or bank entities. Note that the FCS does not apply to cash funds such as these.

It is important to check whether some funds labelled 'cash' are authentic alternatives to cash, or align more with the characteristics of income funds, as this could expose clients to liquidity or capital risk.[3]

Cash alternative red flags

You should investigate further to confirm a fund is true to label 'cash' if it has some of the following features:

- T+1, 2 or 3 availability, as cash funds should allow same-day access
- A buy/sell spread
- Performance fees as well as management fees
- Weighted average of credit ratings
- Invests in mortgage-backed securities (MBS), loans or corporate holdings.

Actively managing liquidity

It has never been more important to understand your clients' expenditure and time horizons—especially if they are feeling uncertain in the current economic climate.

Running out of money is a real risk in retirement. When helping clients plan for retirement, it is important to understand their expected cash flow requirements. For clients who do not want to run down the balance of their investment assets during retirement, a safe withdrawal rate is approximately 2%.

Retired clients with an SMSF also need to have enough cash on hand to meet pension payment requirements. And liquidity may be just as important to younger clients with investments outside of super, who may have higher or fluctuating family and living expenses.

Laddering redemption dates can be a useful strategy for term deposits. Instead of depositing one lump sum in a single term deposit, you could spread the capital across different durations. As each deposit reaches maturity, you can decide whether to reinvest or reallocate. It is important to help clients understand the terms and conditions of a term deposit, and check it meets their needs. Interest rates can also vary widely, based on term and amount invested.

Your clients' hidden pockets of cash

Cash holdings grew during the COVID-19 pandemic, as confidence in equity markets weakened. Household cash reached near historic highs, and at that time, advisers told us they had full vis-

The quote

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Example 1.
Warren is worried he may be made redundant due to a restructure at work. He has $50,000 in a 6-month term deposit, which he has been rolling into a new term deposit each time it matures.

His current term deposit is maturing in two weeks' time and Warren was considering rolling it again because it seems to be the easiest option. However, his adviser Kate reminded him he would need to give the provider 31 days' notice if he wanted to access the funds before maturity. The provider is offering 4.1% p.a. for the new 6-month term deposit, however, if Warren breaks the term early, he will incur fees and receive an interest adjustment.

Furthermore, it is possible that Warren could earn the same, or close to the same interest rate in some cash accounts where the funds could be accessed at call.

Once Kate explains this option, Warren feels more comfortable depositing his term deposit funds into a high-interest cash account on maturity—knowing that if he is made redundant, he can draw on those rainy-day funds straight away.

ibility over less than half of their client base's cash holdings.[4]

There is a possibility you lack the full picture of all your clients' cash. And now is the time to check, because the rates that were acceptable in 2021 are unlikely to be competitive today.

A high interest-bearing account could help clients achieve their goals sooner, as the effect of compound interest can be substantial.

In summary

Cash may be a secure portfolio allocation with relatively predictable returns, but it still needs to be managed proactively—especially in today's market, where cash flow demands may be less predictable, and rates of return vary widely across different providers and cash products. A cash hub account can make it easier for you to proactively manage other investments as well. With liquidity, visibility, security and third-party authority, you can be sure your clients' capital is working as hard as possible by taking advantage of opportunities as they arise. **FS**

Example 2.
Anita and Graham opened a savings account in 2020 to save a deposit of $180,000 for a new home. At that time the account was not paying any interest and now they are receiving 0.5% per annum. They have saved $60,000 and are saving $26,000 every year.

Their adviser Paul had been unaware of this strategy, but when they informed him, he was able to show them modelling for some options offering much higher rates. They moved their deposit to a high-interest account paying 4.5% per annum.

This allowed them to save their deposit eight and a half months sooner which, given rising house values, could make all the difference in securing their dream home.

Notes:

1. 2023 Investment Trends. 2023 SMSF Investor Report: Industry Analysis.
2. Australia Private Banking Council research – April 2023.
3. ASIC, September 2020, ASIC tells funds managers to be 'true to label'.
4. Cash Management Adviser survey conducted by Zing Research on behalf of Macquarie, August 2019.