01:
Olivia McArdle
head of payments and deposits
Macquarie's Banking and Financial Services Group

Many investors may be missing out on cash returns because of their long-held belief that there's barely any wriggle room when it comes to extracting more from their cash holdings.

On the contrary, this is the investment and savings type where financial advisers can better demonstrate the benefits of holistic advice.

For example, there's a way to proactively manage cash and balance the risk and the associated returns. Because these days, investors have the option to weigh their exposure to cash at call, cash equivalent and cash alternatives to suit their needs.

In this issue, we ask Macquarie's Banking and Financial Services Group how financial advisers can help their clients overcome the problem of 'cash complacency'.

Michelle Baltazar
Director of Media & Publishing

We need to talk about cash

Cash has long been considered a safe haven, but there's a lot at stake if it's not managed proactively.

Cash is the ballast in a diversified portfolio. It provides liquidity to fund investment into other assets, reduces the impact of volatile markets and can help preserve capital. However, for conservative investors seeking reliable income with comparative safety, it is increasingly challenging to demonstrate returns.

With official cash rates at an all-time low, it's never been more important for advisers to actively manage their clients' cash portfolios. The challenge may be overcoming investor inertia: clients can see cash as straightforward, and not something they need advice on.

Increased volumes, static returns

During the first half of 2020, as the impact of COVID-19 weakened equity markets and economic confidence, we saw strong increases in cash holdings. According to RFi research into private bank clients, in April 2020 cash at call was second only to real estate as a proportion of total investible assets.

At the same time as cash volumes are growing, cash investment options have become increasingly complex. In the hunt for yield, the number of cash, cash equivalent and cash alternative products has grown exponentially. And some of these products may involve a trade-off between risk and return that may not align with the client's objectives – or satisfy the best interests duty for advisers.

If your clients see cash as simple, you may not get visibility of their full cash holdings. And this can limit your ability as an adviser to provide holistic advice. So how can you overcome this problem of cash complacency?

Defining cash

Investors hold cash for a variety of reasons: as 'just in case' ready cash as a safety net, for increased liquidity in a diversified portfolio, for certainty of capital preservation, or for the ability to act on opportunities as they arise.

Australian Prudential Regulation Authority (APRA) defines cash as cash on hand and demand deposits, as well as cash equivalents. And it has noted that for an investment to be labelled as 'cash' the underlying investments need to be generally considered cash or cash-like in nature.

In our new white paper, *Hidden risks in a safe haven*, we look at three types of products: cash at call, cash equivalents and cash alternatives.

- **Cash at call products** are government-guaranteed and offer total liquidity. These include everyday bank accounts, savings accounts and cash management accounts – such as Macquarie's CMA. In exchange for unrestricted access, interest rates are typically quite low.
- **Cash equivalent products** include term deposits and notice savers, but can also include things like bonds. These types of products offer fixed income at slightly higher returns, with a liquidity trade-off.
- **Cash alternatives** can get a little more complex. Genuine cash alternatives like the Macquarie Master Cash Fund tend to sit low on the risk spectrum. But some funds labelled 'cash' invest outside that asset class. When you unpack these 'cash-enhanced' funds, they may be more like an income fund – and carry higher risk to offset that higher return.

Balancing risk and return

There is growing tension between performance, liquidity and risk, and as a result, an opportunity for advisers to start having more proactive conversations with clients about cash. But if advisers lack visibility over their clients' cash holdings, this raises several potential risks.

At a minimum, investors may be missing out on returns. Funds left untouched in a transaction account are unlikely to receive the most competitive rates, for example. But conversely, when capital is locked away, clients may not be able to access it when they need it, whether to act on opportunities or to meed debt obligations if they face an unexpected life event.

More importantly, advisers could fail to meet their best interests duty obligations if they don't fully understand how these assets are invested consistently with the client's relevant circumstances and the subject matter of the advice they are seeking.

A major part of acting in good faith involves fully explaining the risks of any product recommended. FASEA's Code of Ethics, which came into effect on 1 January 2020, specifically notes the adviser has a duty to investigate the products – they cannot simply rely on the marketing information provided.

So if enhanced returns are on offer, it's essential to read the fine print first.

If a fund's underlying assets include residential mortgage-backed security (RMBS) or corporate holdings, these investments can't be considered 'cash-like'. Other signs to look out for can include charging performance fees as well as management fees, or the application of a buy/sell spread.

The quote

If your clients see cash as simple, you may not get visibility of their full cash holdings. And this can limit your ability as an adviser to provide holistic advice.

Proactive cash management

Meaningful conversations about cash and proactive cash management start with the client's goals, life stage and risk appetite. And those may have changed in recent months – some may be more concerned about losing their income in an uncertain environment, while others might want more liquidity so they can move quickly on market opportunities.

With the client's needs front and centre, you can then show how actively managing their cash portfolios can help them get a healthy rate of return with an acceptable level of risk – while keeping them on track to meet their goals.

Begin the conversation

It's time to challenge that perception that cash is simple. Passive cash investments can create risks. Proactive cash management is essential in the current market.

If you can work with your clients to see their total cash holdings, and make recommendations to help them proactively manage their cash, they will start to see the benefits of active cash management.

As you're having more of these conversations, make sure you understand the underlying investment mix and risk involved in any cash alternative products you recommend to clients – and make sure your clients understand it as well. Because if a return looks too good to be true, it's likely to come with a hidden risk. FS

Watch the video on www.fsitv.com

Brought to you by