

A safe haven, but for how long?

Market volatility has prompted a flight to cash, but how much is really appropriate in a diversified long-term allocation? Amanda White reports

In the past year, one of Australia's largest super funds, AustralianSuper, has reduced its allocation to equities by a massive 10 per cent as a direct result of all new cashflows being directed to cash. At the same time, one of the largest investment wraps, BT Wrap, reports that its newly listed term deposit product has attracted more money than any other product within the wrap, since inception.

The tumultuous markets are having a profound effect on investment allocations, with a lot of investors being scared into cash. But with all that cash sitting in the bank, the purpose of cash and its role in a portfolio need to be re-examined.

Tim Farrelly, principal at farrelly's, says cash is only king in down markets because it allows you to buy things cheaply.

"Clients definitely like cash, and they are very nervous about allocating to other assets, given the markets. Cash is king in down markets but it is only king because it allows you to buy things cheaply. Cash is only useful when it is spent," he says.

While Farrelly concedes the current market volatility represents a "serious crisis", investors - and their advisers - still need to think in the medium to long term.

"Cash rates are good, but they are still only one-year rates; you won't get 7 to 8 per cent over 10 years," he says.

"If anything, clients should be making a change to spending it; now is a good time to buy cheap assets, like equities and property. People are saying they are going to wait until markets stabilise before they allocate, but what they are really saying is they are waiting until prices are 20 per cent higher - that doesn't make sense."

Farrelly says a planner can "earn their keep" now by showing leadership - and now may be a good time to buy assets.

"In the long term people have done better assuming it is not different this time," he says. "The planner's job is to lead the client. At the very least planners should be advising that clients rebalance. They need to take a step back and say they are not good at market timing in the short term."

Certainly it seems the short-term market volatility has unnerved some investors who have re-adjusted their risk profiles, and associated allocations, because of the recent turmoil. But Dante De Gori, technical manager at ClearView Retirement Solutions, also believes that most clients should be adhering

High Interest Online Savings Accounts

Company	Product	Interest rate (%)
BankWest	TeleNet Saver	8.1
AMP Banking	eASYSaver Account	8
ING Direct	Savings Maximiser	8
Horizon Credit Union	HorizonDirect	7.8
Coastline Credit Union	e-Saver	7.75
Qantas Staff CU	Qsaver	7.6
Bank of Cyprus Australia	Midas Account	7.5
HSBC	Serious Saver Account	7.5
Members Equity Bank	ME Online Savings Acct	7.5
one direct home loans	High Interest Saver	7.5
Asgard St George	eCASH	7.4
Big Sky Credit Union	Net Invest Account	7.3
Qld Professional CU	Netsaver Account	7.3
ANZ	Business Online Saver	7.25
Elders ERBOnline	ERBOnline Savings	7.25
Maitland Mutual BS	Internet Personal Acct	7.25
Railways Credit Union	Express Saver	7.25
Heritage Building Soc	on-line s@ver	7.1
NSW Teachers CU	Online Savings Account	7.1
Arab Bank Australia	ONLINE SAVINGS ACCOUNT	7.05
Australian Defence CU	Star Saver Direct Ac	7.05
Illawarra CU NSW	CU+saver	7.05
Satisfac Credit Union	Maxinet Savings	7.05
Unicom Credit Union	CU+saver	7.05
ANZ	Online Saver	7
Bank of Queensland	WebSavings Account	7
Dnister Ukrainian Credit	iSaver Account	7
Easy Street Fin Services	Easy Savings Account	7
ECU Australia	e-Saver	7
FCCS Credit Union	Online Saver Account	7
Hunter United Credit Un	e-ZYNET Direct	7
Laiki Bank	Smart Net	7
Macquarie Credit Union	Money Market Account	7
Nurses First	CashSaver Account	7
Police & Nurses Credit	CashSaver Account	7
Powerstate Credit Union	i-Plus	7
Savings & Loans Cred Un	Online Saver	7
Select Credit Union	Direct Account	7
SUNCORP	Everyday Options Sub-Acc	7
Suncorp Direct	eOptions	7
Victoria Teachers CU	Online Saver	7

Source:www.cannex.com.au, 10th Oct 2008, based on \$10,000 balance



Is your clients' cash growing to its full height?



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What is cash?

Cash sits within the defensive allocation of a diversified portfolio and has a key role of providing income, while being lowly correlated to other assets. But Peter Sumner, portfolio manager, debt, MLC Investment Management, which has about \$7 billion across its cash products, says there is cash and then there is cash. When MLC talks about cash it means pure cash or bank bills and high-quality, mortgage-backed securities. Of the seven Horizon multi-manager funds, only Horizon one and two have any cash in them, with the other products, with longer time horizons, not needing the qualities of that asset class.

"We have only pure cash, bank bills and high-quality, mortgage-backed securities; it is pristine, pure cash - not cash enhanced or CDOs [collateralised debt obligations], greenfields or second-hand loans," he says. "What has been highlighted is that people found they thought they were in cash but had aggressive equity-like exposures - so they were cash by name but not by nature." In the low interest rate environment of the past few years, high-yielding products have been in hot demand. But that has also blown up in the faces of a lot of investors when transparency of the underlying assets was minimal. "In the past three years we have seen

some of the higher-yielding cash-like products flop, such as with Grange Securities' CDOs, CLOs [collateralised loan obligations] and hedge funds, because they are trying to harness the behaviours of the asset class we need in these types of times. In a low interest rate environment everyone wants high yield products, but you can't turn lead into gold," he says. "People have learnt their lesson; the question we are getting now is, what is in your cash fund?" While it is still often appropriate to have higher-yielding, riskier assets within a portfolio, MLC's argument is they need to be allocated appropriately for the right time horizon to allow the value to come

through. For example, with credit exposures, a higher risk tolerance and longer time horizon are needed. "We call cash, cash. In this type of environment there are very correlated risks, like between credit and equities, but we are not trying to create equity-like returns from cash and fixed interest," he says. "Some clients are de-allocating from other aggressive assets into cash, but if you have a good adviser who has kept you on the straight and narrow and not misdirected your risk tolerance in the first place, then you will be OK."

to their long-term strategy, and that that strategy should include some cash in the first place.

"Where possible, we advise to stick to the long-term asset allocation, whereas some clients are now changing their perceived level of risk because of the downturn," De Gori says.

He believes that in a diversified portfolio, unless a client is 100 per cent aggressive, there should still be some cash reserve.

"For retirees in particular, having some cash in the portfolio comes into play in times like this, as it allows them to draw down income without having to crystallise any assets and so allow the aggressive assets to do their work," he says. "If a portfolio doesn't have cash and you are forced to draw income from aggressive assets, then the impact is a double whammy for your portfolio."

There is definitely an argument to hold cash, but how much is appropriate is not straightforward, with allocations so dependent on individual situations.

But De Gori believes a good aim is to have two to three years of income in cash, which he defines as an asset with no exposure to equities that produces income and that includes cash, cash guarantees and fixed income.

While asset allocation decisions are driven by a client's personal needs and situation, when it comes to cash allocations, Doug Webber, associate director, Macquarie Wealth Management, who is a financial planner by trade, believes the biggest factor is how long a client has been in, or out, of the sharemarket.

"If you have been in the sharemarket for 20 years, then there is no point taking your money out; but just stay with your long-term allocations and ride this out. With a lot of clients, allocations to cash have probably not changed by definition, but the relative value of equities has decreased because of the sharemarket. We are selectively advising rebalancing if you are a long-term investor because there are some bargains out there to have now," he says.

"If you have been out of the market for five years, we are having a lot of conversations around holding the line; we say don't get out of equities and dive into cash, but if you have cash, hold on to it and see what happens."

For Macquarie advisers, he says, the most interesting conversations are with those who have come into cash by some life event and who want to know what to do with it. It becomes a question of how to

manage the cash exposure.

"With the market interest rate decrease, then a term deposit is a good way to go because you can lock in today's rates. Logic suggests term deposits will do well," he says.

And while there is no one-size-fits-all approach, Webber says the advice given to clients is to imagine the worst-case scenario, which is different for different people.

"At this stage more than any in my career, our conversations with clients have to be really personal. We encourage planners and their clients to be really open about how they feel and their objectives. It is time to get up close and personal."

With that in mind, advisers could do well to consider the human behavioural biases that can have a large impact on an individual's investment decisions, particularly when markets are down.

John Dani, national manager for advice development at ipac, says the flight to cash being experienced in markets now is the primitive man equivalent of hiding in caves when faced with a new event never confronted before.

"Hiding in their caves in an investment sense is being in cash," he says.

Dani believes there are three driving behav-



High interest for your clients.



journal traps behind the cash investments.

The first is loss aversion, where people have a stronger tendency to avoid losses than seek gains.

"If there is a clothing sale with 30 per cent off prices then you can't hold the doors down, but if you apply that to markets and say prices are 30 per cent off [on] the sharemarket, people don't see an opportunity to buy," he says.

The second behavioural bias is saliency, where people tend to look at recently observed events and overestimate the likelihood of it happening in the future. For example, if there is a shark attack, people won't go to the beach the next day.

The third is herding.

"The stockmarket is an interesting beast, but it is not a foreign entity that makes decisions or has an intellect. It represents the buy and sell decisions of millions of humans, who all suffer from behavioural weaknesses," he says. "It takes a lot of courage to go against the herd."

These three things are all coming together powerfully and driving the flight to cash.

In recognition of the difficulty in changing thousands of years of hard wiring, and in anticipation of times such as these, ipac has quarantined two to three years of clients' portfolios into cash so they don't have to crystallise assets - and this has provided some resilience for clients.

While the markets are down, it is important for advisers to know their client base. For some, in the drawdown phase, the current market conditions may mean they need to temper their spending and defer lump sum expenditure.

In the past six months, since launching its term deposits in April, BT Wrap has seen more than \$1.3 billion flow into that product, which Craig Lawrenson, BT Wrap head of product and strategy, says blows every other product on the wrap out of the water.

"The largest funds manager relationship BT Wrap has is just over \$1 billion, since operation, and this has received more than that since April," he says.

Platforms are the facilitators of the investment advice process, or the outputs of advice, not the

Term Deposits - 1 year	
Company	Interest %
Gateway Credit Union	8.15
BankWest	8
TAFE & Community CU	8
Suncorp	7.8
Select Credit Union	7.75
UBank	7.75
Australian Defence CU	7.55
Credit Union Australia	7.5
FCCS Credit Union	7.5
Bendigo Bank	7.45

Term Deposits - 6 months	
Company	Interest %
Gateway Credit Union	8.4
Arab Bank Australia	8.1
Elders ERBonline	8.05
Elders Rural Bank	8.05
Members Equity Bank	8.05
Select Credit Union	7.9
TAFE & Community CU	7.9
BankWest	8
UBank	7.9
Bendigo Bank	7.7

source: www.cannex.com.au, 9th Oct 2008, based on \$10,000 deposit

But for other groups the situation is different. Dani says clients that are very young and have money in super should be euphoric about today's markets.

"This is a time where they can acquire assets at a very low price; they don't need to access it for at least 20 years, so what happens in the next 20

days doesn't matter. Similarly, for those around 55 years of age there is still a lot of time, so we would encourage them to gain the courage to stay with their long-term asset allocation."

Farrelly agrees the appropriate cash allocation is different for each person depending on their circumstances, and for some it could be a "negative allocation", or borrowing of money.

"If you had the income to meet all the interest payments I would be encouraging borrowing to put money in the market," he says. "The asset allocation process I go through is looking at what you are getting for what you are paying. At the moment my calculations are [that] over 10 years you can get about 11 per cent per annum for Australian equities; one year ago that 10-year forecast was about 6 per cent a year."

Farrelly says if clients have the ability to look long-term then it shouldn't matter about the current crisis and how it will be fixed. And he says planners need to encourage clients to look long-term.

"Planners are overly concerned about the short term, but they should be worried about the long term. Even when you are a retiree you should be looking out 10 years," he says. "Cash of itself, I can't say what the appropriate allocation should be; so much depends on the individual. But everything else being equal, if you had 30 per cent in cash, then you should reduce that to about 15 per cent; there are so many good deals out there if you can take the volatility."

inputs. So from that perspective, what allocations flow into which products is a direct reflection of the advice process.

"These flows into the term deposit are reflective of the timing. At the beginning of the year advisers were saying there was demand for capital stability, and term deposits have turned into a sexy thing of the future because of the rates," he says.

Within four to six weeks of the initial demand, the product was on the wrap and in the first month gained flows of \$90 million, with the current peak of August seeing \$390 million in flows into the

term deposit.

In addition, the traditional working cash account has gone from about 8 to 11 per cent of the total book since April. So cash is certainly king as far as the wrap reflects.

Macquarie's Doug Webber believes the old adage that "cash is king" is pretty close to the mark right now.

"A lot of people are sitting on the sidelines to see how long it plays out. Some are saying every day is closer to the end, but there is still a very high demand for cash and cash-like products. Macquarie



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Cash Performance Survey (net of fees)

Fund Name	APIR	1 Mth (%)	3 Mths (%)	6 Mths (%)	1 Yr (% p.a.)	2 Yrs (% p.a.)	3 Yrs (% p.a.)	4 Yrs (% p.a.)	5 Yrs (% p.a.)
Aberdeen Cash Plus Fund	MGL0101AU	0.32 (15)	-1.03 (15)	0.09 (15)	0.54 (14)	3.12 (13)	4.05 (13)	4.57 (13)	4.81 (13)
BT Institutional Enhanced Cash Fund	WFS0377AU	0.36 (14)	1.14 (14)	2.73 (13)	4.56 (13)	5.27 (12)	5.47 (12)	5.58 (10)	5.59 (10)
Cash Account	N/A	0.67 (5)	2.00 (3)	4.03 (2)	7.67 (1)	7.07 (1)	6.65 (1)	6.40 (1)	6.21 (1)
Colonial First State Wholesale Cash	FSF0075AU	0.71 (2)	1.99 (4)	3.94 (4)	7.22 (5)	6.67 (5)	6.26 (4)	6.03 (4)	5.85 (5)
Credit Suisse Cash Fund	CRS0009AU	0.69 (3)	2.01 (2)	3.86 (6)	6.97 (7)	6.55 (6)	6.28 (3)	6.11 (3)	5.98 (3)
DDH Cash Fund	DDH0009AU	0.58 (11)	1.73 (11)	3.47 (9)	6.03 (10)				
Macquarie Cash Management Trust	MAQ0001AU	0.57 (12)	1.69 (13)	3.37 (10)	6.39 (9)	5.87 (10)	5.48 (11)	5.25 (12)	5.05 (12)
Macquarie Master Cash Fund	MAQ0187AU	0.62 (9)	1.85 (8)	3.65 (7)	7.01 (6)	6.49 (7)	6.08 (8)	5.84 (9)	5.65 (9)
Macquarie Master Cash Plus Fund	MAQ0060AU	0.62 (8)	1.73 (12)	3.14 (11)	5.52 (12)	5.64 (11)	5.56 (10)	5.51 (11)	5.45 (11)
Money Market Investment Account	ZIP0153XX	0.58 (10)	1.75 (10)	3.49 (8)	6.84 (8)	6.48 (8)	6.15 (7)	5.94 (7)	5.76 (8)
UBS Cash Bond Fund	UBS0001AU	0.67 (4)	1.96 (5)	3.98 (3)	7.36 (4)	6.75 (3)	6.26 (5)	6.03 (5)	5.91 (4)
UBS Cash Fund	SBC0811AU	0.65 (7)	1.93 (7)	3.90 (5)	7.41 (2)	6.84 (2)	6.42 (2)	6.17 (2)	5.98 (2)
UBS Cash-Plus Fund	SBC0812AU	0.48 (13)	1.80 (9)	3.12 (12)	5.83 (11)	6.00 (9)	5.91 (9)	5.86 (8)	5.78 (7)
UBS Credit Enhanced Fund	UBS0102AU	0.67 (6)	1.93 (6)	0.74 (14)	0.04 (15)	2.84 (14)	3.85 (14)	4.39 (14)	4.66 (14)
Vanguard (W) Cash Plus Index Fund	VAN0102AU	0.87 (1)	2.39 (1)	4.40 (1)	7.41 (3)	6.70 (4)	6.21 (6)	6.01 (6)	5.83 (6)
Funds		15	15	15	15	14	14	14	14
Average		0.60	1.66	3.19	5.79	5.88	5.76	5.69	5.61
Median		0.62	1.85	3.49	6.84	6.48	6.11	5.90	5.77
Lower Quartile		0.57	1.73	3.12	5.52	5.64	5.48	5.51	5.45
Upper Quartile		0.69	2.00	3.98	7.41	6.70	6.26	6.03	5.91
UBS Bank Bill Index		0.67	2.00	4.03	7.67	7.07	6.65	6.40	6.21

*The figures in brackets represent each fund's ranking (ranked individually) within the universe displayed.

cash management trust (CMT) has seen no significant net flows, but the competitive term deposits we have launched are selling like hot cakes," he says.

Peter Shepherd, head of distribution for Macquarie Adviser Services, says Macquarie has just under \$1 billion in term deposits from independent financial advisers (IFAs) and that the absolute increase in cash has flowed into a number of different products, including the CMT, the term deposit, and Cash XL, which is a separate no-frills cash enhanced online product, launched in May, which has about \$500 million.

The Macquarie CMT, which has about 9000 active users, is used primarily as a cash hub, or cashflow tool, rather than an investment per se. The term deposit and XL are used as the investments.

The Cash XL product is differentiated from other online accounts because it was designed for financial planners, giving them visibility of clients' accounts, the same way the CMT does.

"Financial planners know what is in the account

and what the activity is and this is an important tool for financial planners to have full information," Shepherd says.

"Planners use the CMT for their own business, and also to recommend to clients as a cash hub. [It's] used a lot for self managed super funds to manage cash flows daily. With functionality the main difference between CMT and the other cash investments, the rate is not the dominant issue."

But for the term deposit, and online products such as Cash XL, which has a rate of 7.75 per cent, it is all about the rate.

According to Peter Arnold, financial analyst at Cannex, in the past six months to a year there have been some very high rates on three-month to one-year term deposits.

"The days of only the two to five-year terms having high rates are gone; now it is much shorter terms. But recently, with the RBA cuts, we have seen a lot of the term deposits come down. If mortgage rates come down, then deposit rates

come down too - they run hand-in-hand. The last couple of interest rate decreases have seen some of the highest rates in term deposits - but there is no guarantee that will stay around."

Arnold says assessing term deposits is not too complicated, with the main concern being the rate, but also when the interest is paid, and whether the product is compounding or not (although most are not).

"A lot of institutions offer special rates for certain terms, so clients have to be realistic about when they need their money back," he says. "Also, when the term deposit comes up for maturity, make sure you are on the ball, because if you are not then you might get locked in again, but in what might be a wildly fluctuating rate after the initial term expires."

"With the RBA rate drop of 1 per cent there are many term deposit rates coming down significantly. This makes the point of making sure you don't get locked into a lower rate when it is time to rollover even more important." ■



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Macquarie Cash XL

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