Cash

Understanding cash

Cash plays an important role when it comes to investing. What exactly is cash and what should members be aware of when it comes to cash investments? This fact sheet explains what cash means, how AustralianSuper uses cash in the investment portfolio and some of the pros and cons of cash investments.

What is meant by cash?

Most people refer to cash as the notes in their wallet or the savings in their bank account. From an investment perspective, cash refers to a range of investments, known as money market securities.

These usually have a maturity period of less than one year and provide a high level of liquidity.

Some examples of money market securities are:

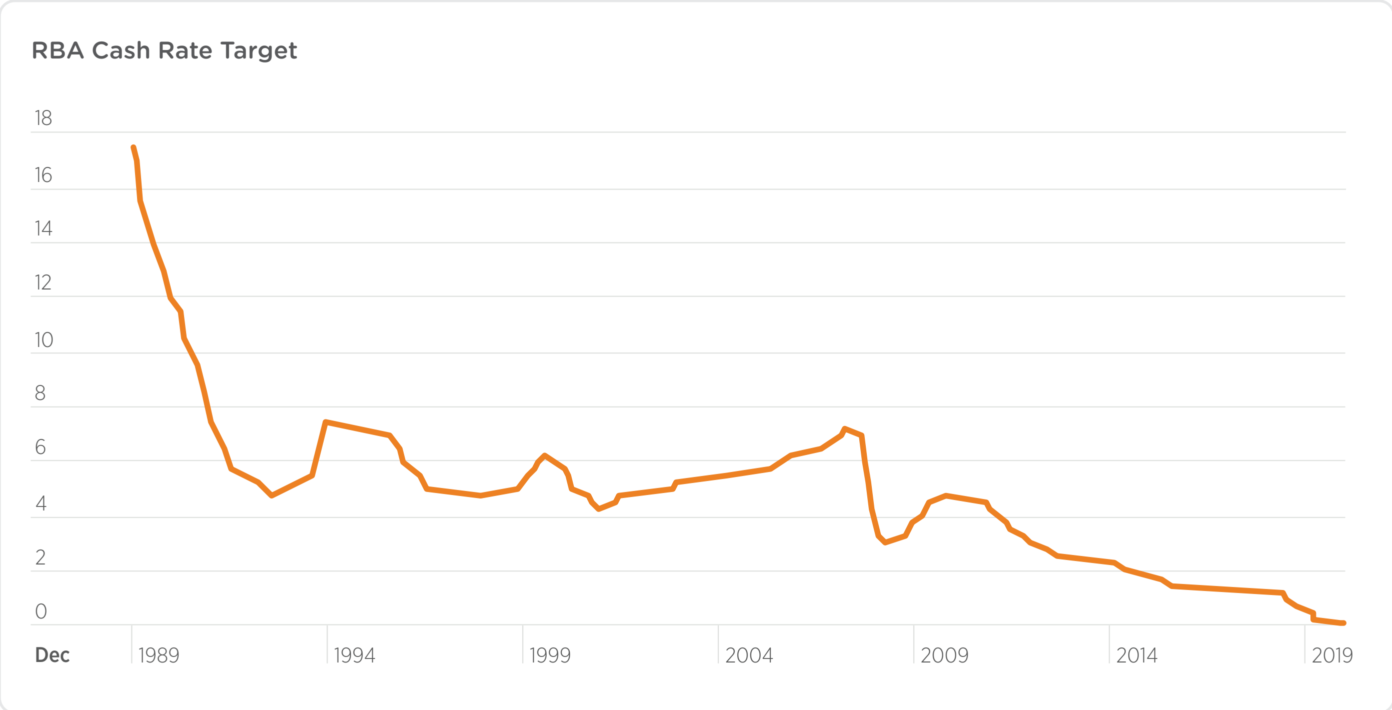
- **Cash** – A cash transaction is the simplest form of transaction in the money market and occurs overnight (known as the 11am call) or another determined fixed period. The cash market allows investors to park their cash for the short term, while still gaining some interest. It's also a liquid asset so investors can access it quite easily.
- **Treasury notes** are issued by the Federal Government for short-term funding requirements. They're issued at a discount and are redeemable at face value on maturity.
- **Promissory notes** or **Commercial paper** are 'promises' to repay a certain amount of money at a future date. They are issued by companies to meet short-term debts like payroll and accounts payable. They are unsecured which means they're only available to credit-worthy companies.
- **Bank Bills** are the most traded security in the short-term money market. They typically mature within one year and are sold at a discount to face value. A bank's name appears as the acceptor of the bill which means the bank is liable to pay the amount of money due on the bill's maturity to the holder of the bill. They are considered excellent credit and therefore trade at the lowest yields due to their security.
- **Term deposits** are fixed-term investments issued by financial institutions that reach maturity ranging from one month up to a few years. They're often considered to be less liquid as the investor can only withdrawal their assets when the term ends. To provide an incentive for locking in the investment for a fixed time, term deposits may offer a higher interest rate compared to more liquid money market options.

This document has been prepared and issued in September 2021 and is subject to change.

Driving factors of Cash option returns

It's important to note that market interest rates are the main driver of returns for most money market securities. Higher interest rates can lead to higher returns, and the same goes for lower interest rates resulting in lower returns. These market interest rates are derived from the official cash rate set by the Reserve Bank of Australia (RBA).

In recent years, the RBA's monetary policy has been supportive of economic growth. This has resulted in a lower cash rate target over time. While this supports the economy through lower lending costs, it also lowers the return that investors receive on their cash deposits.



Characteristic of cash investments

Cash investments in super have a lot of similar characteristics to your savings in a bank account:

- Stability: Cash has the lowest level of risk. The value of a cash investment is unlikely to significantly decline, providing added portfolio stability.
- Interest: Cash investments provide a return that is based on short-term rates. Like bank accounts, cash instruments earn interest, which is based on market interest rates that are influenced by the RBA Cash Rate Target.
- Liquidity: Similar to a bank account, cash securities in an investment portfolio provide liquidity, so assets can be easily accessed to make payments or to go into longer-term investment opportunities.

How is cash used in an investment portfolio?

In a bank account, cash is often used for daily spending and provides a safety net to pay for expenses. In a super fund, cash is used in a similar way so each portfolio has the liquidity to meet daily cashflow needs:

Money coming in	Money going out
Super contributions from existing members.	Cash payments to members who are drawing from their super, for example in account-based pensions such as Choice Income.
Transfers from new members who join the Fund.	Transfers to people who leave the Fund.
Dividends and other income from our investments.	Taxes paid on contributions or income earned.
Proceeds from the sale of investments.	Cash purchases of new investments.

The AustralianSuper investment team ensures there is sufficient cash available to meet these needs.

How AustralianSuper invests in cash

Cash is managed as an asset class in the PreMixed and DIY Mix investment options.

AustralianSuper invests in cash to provide portfolio liquidity so there's enough cash for additional longer-term investments – or to ensure there's enough liquid cash in the fund to meet member payments.

Improved returns in the cash portfolio are achieved through security selection, credit selection and interest rate management. Our investment team use our size, stability and trusted relationships to negotiate better interest rates.

Please note

Based on APRA guidance, cash investment options should be readily accessible for withdrawal or transfer without change in value. APRA's definition of cash is drawn from the AASB 107 meaning of 'cash or cash equivalents' that comprises of cash on hand or short-term highly liquid investments, readily convertible to known amounts of cash. This means that the Cash investment option would not have exposure to asset-backed, mortgage-backed or other securities that do not meet APRA's definition of cash. Within the PreMixed options, the portfolio manager may invest in a wider range of cash instruments that can add value to the investment return.

Disadvantages of investing in cash

Although cash can provide security for the capital in a portfolio, due to a low chance of a drop in value, the lower risk translates to a lower return.

- Cash investments have a low expected return compared to other assets like listed shares, private equity, direct property and infrastructure. Cash instruments have lower yields than longer-term fixed interest assets, which can also be used to provide diversification and portfolio stability.
- With current interest rates, the return on cash investments is very low with current yields below 0.50% per annum. When market interest rates are low, cash can even have zero or negative returns after fees, costs and taxes.
- While cash generally provides stability, some cash instruments do have a small level of interest rate risk which can impact the value of the security. This is due to the inverse relationship of price and interest rates. An increase of short-term interest rates in the market can decrease the price of short dated cash instruments in the portfolio.

It's also good to know when investing for retirement, a key goal is to outpace wage inflation to help meet long-term income requirements. Having too much of a retirement portfolio in cash means that it's less likely to significantly outpace wage inflation and provide the best possible retirement outcome.

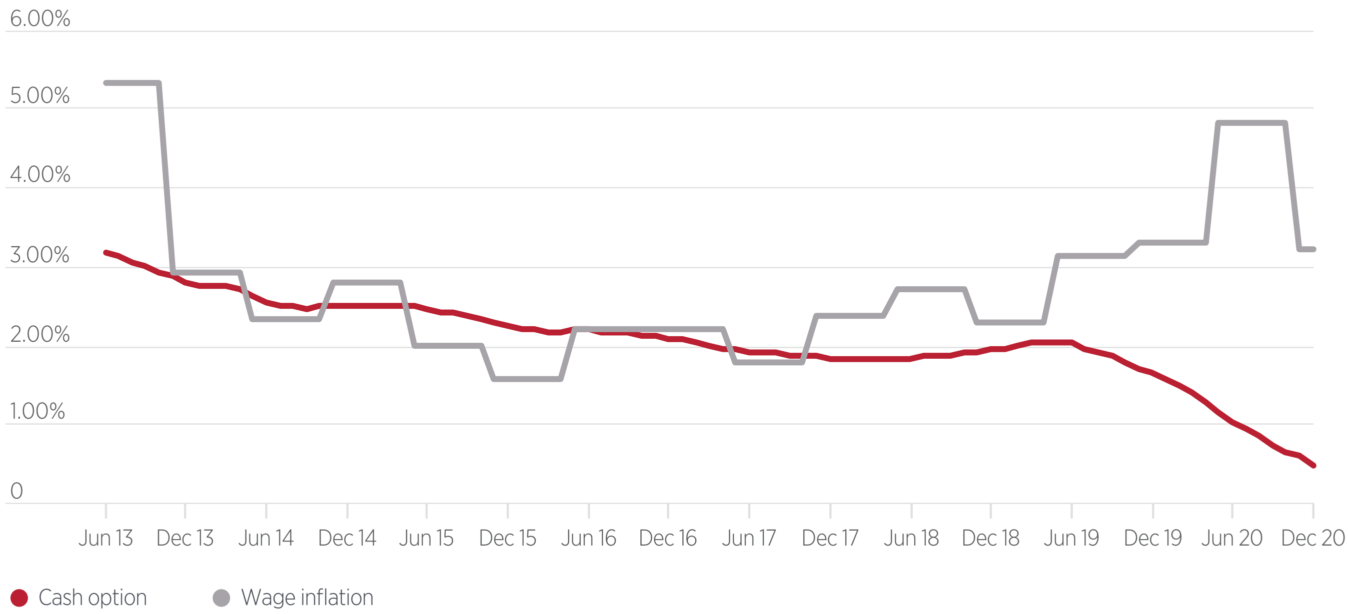
So when it comes to cash investments, just like any portfolio activity, It's all about having the right balance.

AustralianSuper's Cash option

AustralianSuper provides the Cash option as an investment choice for members who are looking for capital stability or short-term liquidity. This capital stability is balanced by lower expected returns for the option.

The potential for the Cash option to outperform wage inflation has reduced considerably in recent years. Short-term interest rates are expected to remain low in the near-term and investing in cash is unlikely to keep pace with rising costs. The graph below shows the trend in the 1-year return of the Cash option. Cash option returns over the past few years are tracking below the level of wage inflation.

Cash option compared to wage inflation
Rolling 1 year returns and wage inflation % change



Source: AustralianSuper and ABS. Wage inflation uses ABS Average Weekly Ordinary Time Earnings (AWOTE), based on semi-annual observations.

In summary

Cash is an important asset class in a diversified portfolio to meet specific short-term goals, especially in providing liquidity. While cash investments can be compared to a bank savings account, institutional investors like super funds can choose from a range of additional cash securities to help improve returns in a cash portfolio. These investments offer some income and provide liquidity for managing transactions in a diversified investment portfolio.

While cash is often considered a risk-free investment, low yields and the potential for a moderate level of negative returns in cash instruments means the opportunity cost of investing in cash could be lower returns compared to growth assets. For longer-term investment objectives, it may be beneficial to limit the allocation to cash investments, as the asset class provides the lowest possibility of achieving the returns that can significantly increase the value of a portfolio and outpace inflation.

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