

# BlackRock® What do terminal rates mean for cash management?

## Investor considerations

### Cash segmentation

Operating, core, strategic

#### Put your cash to work.

Investors could take time to consider that their operating and core cash positions utilise MMFs, effectively avoiding being in low/no interest-bearing undiversified bank deposits.

Cash management strategies should consider the different requirements for your operational, core and strategic cash balances.

Utilising different types of MMFs and segmenting appropriately may help investors put their cash to work by maximising the benefits of more flexible credit and duration thresholds in strategic cash allocations without the increased volatility which can be found by venturing into fixed-income products.

### Economic outlook

2024

Looking at forward pricing from central banks and the market assumption that rates are likely to stay higher for longer, if this is indeed the case, investors may benefit from these higher rates being passed through MMFs for years to come.

When rate cuts are priced in and there is an inverted yield curve, short-duration investing may offer competitive risk-adjusted returns, locking in short-term yields.

### Risk tolerance

Volatility

Relative 'certainty' of central bank rates does not equate to general market stability, and as we have seen, outlooks can quickly change. Investors must be prepared in case of more volatility in the coming quarters and are aware of the risks of investing further out the curve.

MMFs remain high quality and low volatility investments available to investors and are often favoured by investors in volatile markets in uncertain times to possibly mitigate market losses.

**In the past 12 months, many developed market central banks have gone through a sustained period of interest rate rises at an unprecedented pace. As a result, short-term exposures have been appealing from an income perspective. Consequently, investors have looked to money market funds (MMFs), which have been uniquely poised to rapidly absorb the interest rate hikes with minimal downside risk.**

**We expect central banks to cut rates this year** – as such, questions have been asked about what will happen to MMF flows.<sup>1</sup> We see an opportunity from a cash portfolio management perspective to stay ahead of cash alternatives for investors and seek attractive yields whilst mitigating market loss in an environment still rife with economic risks and uncertainty.

## Portfolio management

### Potentially maximising Alpha by utilising duration and credit

The structural shift we have seen from central banks indicates they won't be coming 'to the rescue' with rate cuts as they have done historically during periods of declining growth. As a result, both duration and credit may play an important role in enhancing returns for investors.

As we move into an environment where there is more certainty about the future path of rates, managers may extend duration to a more neutral stance with less risk of near-term mark-to-market movements on fund net asset values (NAV). The funds may also benefit from taking measured credit risk within MMF parameters seeking to enhance the portfolio yield.

Throughout 2023, MMF managers held higher than average liquidity levels to mitigate against volatility in rate movements and investor flows.<sup>2</sup> They accomplished this by relying on reverse repurchase agreements backed by government, government agencies and overnight time deposits which typically track closely to the overnight risk-free rate. With more clarity on the rate path, fund managers may benefit by moving to a more balanced portfolio daily and weekly liquidity and diversifying their asset allocation<sup>2</sup> in terms of security type as well as duration. This could see the portfolio climbing away from the risk-free rate in terms of portfolio performance and may offer even more attractive yields for clients.

### Capital preservation and liquidity

In the quarters ahead, we expect risk sentiment to be highly sensitive to surprises in inflation, growth and monetary policy. It is more important than ever that investors consider their risk appetite given the large degree of uncertainty still in the industry.

Holding short-term MMFs has been protection for many against mark-to-market losses in the rising rate environment. This is especially true now, given rates have spiked to their highest levels in decades. Volatility is expected to continue in 2024. Stagnating developed market growth, escalation in geopolitical tensions as well as significant democratic elections all over the world play into the theme of more uncertainty for economies everywhere. Money market funds are still uniquely positioned to focus on capital preservation and liquidity. Their widely perceived view as a 'safe haven' for assets could see them as an attractive place for clients to park funds and ride out any volatility in 2024.

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A Money Market Fund (MMF) is not a guaranteed investment vehicle. An investment in MMFs is different from an investment in deposits; the principal invested in an MMF is capable of fluctuation and the risk of loss of the principal is to be borne by the investor. The MMF does not rely on external support for guaranteeing the liquidity of the MMF or stabilising the NAV per share.

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