IMPROVING RETURNS IN A LOW-RATE ENVIRONMENT

Even in today's low-rate environment, it is possible to align your company's short-term cash strategy with the objectives of your investment policy.

Economists and other market experts do not expect rates to rise in the near future. The most recent estimates indicate that rates will remain low at least until the middle of 2015. And in this sustained, low-rate environment, the benefits of active liquidity management are reduced.

REGULATORY CHANGES LIMIT CASH MANAGEMENT OPTIONS

It has become more important to define the balance between risk and return due to the recent expiration of unlimited insurance on non-interest-bearing transactional deposits. Now is the time to re-evaluate the balances you maintain in these accounts and determine how your current allocation aligns with the investment style, risk tolerance and thresholds for counterparty risk you currently have defined in your investment policy.

Bank regulations, such as Basel III, have prompted banks to define the appropriate value of deposits, weighing factors such as duration of funds and depth and profitability of client relationship. Additionally, the appetite for deposits may vary across banks, given the structure and various requirements of their balance sheets.

Some financial institutions may be more willing than others to accept additional deposits from their clients, and different financial institutions may offer different rates. The potential for a new money market fund reform initiative has resulted in continued uncertainty. This uncertainty is likely to continue throughout 2014, as proposed reform, especially around floating NAV and fund holdback requirements, is causing concern among traditional investors in these funds.

LIQUIDITY INSTRUMENTS FOR TODAY'S ENVIRONMENT

Sophisticated investors of short-term cash may still utilize several liquidity instruments in this environment. These investors tend to have large balances and in-house expertise to actively manage their liquidity portfolio. Those entities that do not house the requisite expertise may opt for managed investment options.

As in any environment, it is imperative for treasury professionals to segregate their cash based on usage and develop an appropriate strategy to fulfill the short- and long-term needs of their companies. Short-term liquidity can be thought of as having three components:

- *Operational Cash* comprises cash needed for day-to-day operations. These funds are generally held in investments that are very liquid and provide nearly immediate access.
- *Cash held in reserve* typically serves as a cushion for unforeseen events. The investment strategy for this cash is also fairly conservative.
- *Strategic cash* is reserved for a particular duration and purpose. Risk tolerance and time horizon tend to drive the instruments used for this cash.

Once the environmental and internal factors are weighed, companies may choose one of the following vehicles for managing their short-term cash:

- *Bank deposits* include analyzed checking accounts that receive a "soft" earnings credit to offset cash management fees, as well as interest-bearing checking and money market deposit accounts.
- *Fixed-income securities* can meet guidelines of an investment policy.
- *Managed portfolios* such as money market funds or separately managed accounts are also an option.

According to the *2014 Association of Financial Professionals Business Outlook Survey*, two-thirds of financial professionals believe rates will stay relatively the same in 2014.

Even in this low-rate environment, it is important to stay apprised of market trends and regulatory changes. Those external factors, as well as your own internal objectives, should drive how you manage your company's short-term cash now and in the future.

For more information, contact your Relationship Manager or visit pnc.com/treasury.

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