



CASH LEVELS ARE RISING, AND RATES ARE FALLING – ARE YOU OPTIMIZING YOUR LIQUIDITY?

HIGHLIGHTS

- ▶ Organizations with excess cash may benefit from proper liquidity management by partnering with the team at Fort Washington to better manage this process and potentially realize the value of cash segmentation to increase interest income.
- ▶ Basel III and the return to a ZIRP (zero interest rate policy) environment has changed the landscape for liquidity management dramatically.
- ▶ Understanding cash segmentation can help organizations properly balance risk, return, and liquidity.
- ▶ Active cash management requires effective and regular communication with clients, a key tenet of Fort Washington’s Liquidity Management Strategy.
- ▶ By thoroughly understanding liquidity needs and properly segmenting cash, investment income can be increased materially.

INTRODUCTION

Despite ultra-low money market yields, cash balances have risen across the globe as institutions seek to navigate these uncharted times. Many organizations—universities, health care institutions, non-profits—are not optimizing their cash balances and are failing to benefit from additional income that may be earned with a cash segmentation strategy. As organizations grow and needs become more complex, cash and liquidity management is often overlooked. If your organization has excess cash, the liquidity management team at Fort Washington can partner with you to better manage this process so that you may realize the benefits of cash segmentation. This allows you to focus your time on managing your business and other critical tasks, while potentially helping to enhance your bottom line.

Using current yield levels for various liquidity instruments, we have demonstrated how a basic cash segmentation strategy could result in additional interest income in this hypothetical example:

Hypothetical as of August 2020:

Basic Cash Strategy	Purpose	Assets	Yield	\$ Income
Prime Money Market Fund	Sweep	50,000,000	0.15%	\$75,000
Cash Segmentation Strategy	Purpose	Assets	Yield	\$ Income
Prime Money Market Fund	Operating Cash: Daily Liquidity	20,000,000	0.15%	\$30,000
Enhanced Cash	Tactical Cash: Monthly Liquidity	10,000,000	0.24%	\$24,000
<u>Ultra Short Duration</u>	<u>Strategic Cash: 6-12+ months</u>	<u>20,000,000</u>	<u>1.15%</u>	<u>\$230,000</u>
Total	Optimized Cash Strategy	50,000,000	0.57%	\$284,000
Difference			0.42%	\$209,000

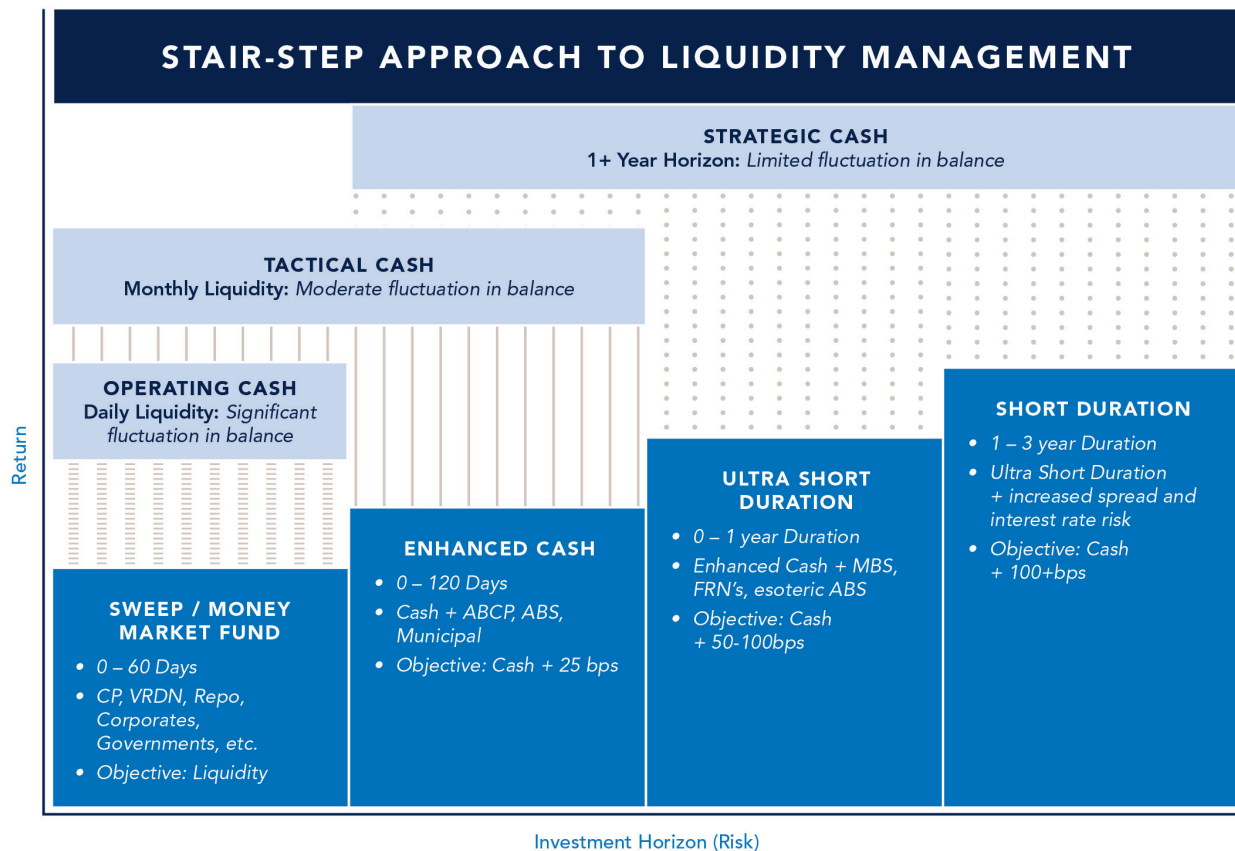
Source: Fort Washington. The above hypothetical is being presented for illustrative purposes only, and represents an example of cash management strategies and allocations. Actual allocations, yield, and income will be different from those shown, depending on current market and economic conditions, and client-specific needs. Yield shown does not reflect a single source, but was approximated using a variety of average yield calculations and representative portfolio holdings as of August 2020. Income shown does not take into consideration any account fees and expenses that may be incurred with the management of a similar strategy. Past performance is not indicative of future results.

BASEL III IMPLICATIONS

The Basel III international regulatory framework for banks was implemented in the U.S. in July 2013. (For additional background, please see "[Pay Attention to Your Cash.](#)") The purpose was to ensure that banks had adequate capital and liquidity in times of stress. The new rules made non-operational deposits from a bank's institutional customers hugely unprofitable. As a result, banks have reduced the interest rates on these deposits, effectively forcing customers to find alternative cash investments. Therefore, Treasury managers and CFO's have begun seeking alternative liquidity solutions such as institutional enhanced cash and ultra-short duration products.

BALANCING LIQUIDITY, RISK, AND REWARD

The graphic below illustrates Fort Washington's approach to liquidity management. Much like how one might choose asset classes to help achieve various life goals, cash objectives can be segmented similarly. In this example, we show three typical segments of cash, each with their own unique objective: Operating Cash, Tactical Cash, and Strategic Cash. A tailored liquidity management solution that incorporates active investment management can optimize each segment by stepping up and down the return-risk spectrum of short-term market instruments.



Source: Fort Washington. ABCP: Asset-Backed Commercial Paper, ABS: Asset-Backed Security, CP: Commercial Paper, FRN: Floating-Rate Note, MBS: Mortgage-Backed Security, Repo: Repurchase Agreement, VRDN: Variable Rate Demand Note.

PARTNERING WITH CLIENTS

The Fed adopted a zero interest rate policy (ZIRP) in March 2020, effectively driving money market rates close to zero. Investors are once again forced to focus on an asset class that is often overlooked, similar to the last ZIRP environment from 2009-2015. Although the fundamentals of liquidity management have not changed, the investment landscape has changed dramatically. By having a thorough understanding of our clients' liquidity needs and risk tolerance, as well as a deep knowledge of cash segmentation strategies, Fort Washington's Liquidity Management team can structure an optimized portfolio aimed at generating a meaningful additional return on cash investments.

A key tenet of Fort Washington's Liquidity Management Strategy is effective and regular communication with clients. This allows us to gain a thorough understanding of clients' cash needs and how these needs may change on a real-time basis. In fact, many clients view our strategy to be accretive to their internal treasury function.

With this construct, we are able to work toward optimizing returns while providing proper liquidity management, adhering to policy constraints and risk tolerances with preservation of capital as an overriding goal. The process may be summarized as follows:

- ▶ Investment Horizon/Liquidity Ladder
 - Analyze historical cash balances to determine confidence intervals for a maximum downside scenario
 - Apply knowledge of the cash segmentation "stair step" to develop a liquidity plan
 - Immunize known cash flows
- ▶ Risk Tolerance
 - Determine universe of investable assets and create an Investment Policy Statement (IPS) to govern liquidity, credit quality, diversification, maturity, and other risk drivers
- ▶ Risk Management
 - Utilize best-in-class third-party systems and proprietary tools for compliance and risk monitoring

Fort Washington believes there is significant value to be realized by dynamically managing cash assets in a cash segmentation framework. Understanding clients' liabilities and near-term cash flow needs allows us to determine allocations using this stair-step approach. Optimizing returns goes beyond this allocation process—it incorporates relative value analysis and taking advantage of opportunities offered by the yield curve and credit spreads.

WHAT IS YOUR OPTIMAL LIQUIDITY SOLUTION?

Each investor's needs and objectives are unique. A prudent investor understands all investment objectives, keeps current with the market environment, and stays abreast of dynamic and changing investment options. By having a thorough understanding of a client's liquidity needs and properly segmenting cash, significant value can typically be added through a proper liquidity solution.

WHY FORT WASHINGTON?

Fort Washington adds value through unparalleled customer service. Our liquidity management team strives for strong ongoing communication in order to manage expectations as they relate to client risk tolerance, investment returns, and investment policy statement construction and compliance. We recognize that liquidity and safety of principal are paramount when managing cash and want to help clients become comfortable with the agreed upon levels of portfolio risk and return.

We believe actively managing cash can allow organizations to tailor liquidity needs while optimizing returns. If your organization is not optimizing cash balances and failing to benefit from additional income that can be earned with a cash segmentation strategy, we hope that you will contact our team at Fort Washington to better manage this process and realize the benefits of active liquidity management.

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