01:
Alex Vynokur
managing director,
BetaShares

Know your product: Cash ETFs

Whether your client is already in or nearing retirement phase or a young investor at the start of their savings journey, cash has an important role to play in every portfolio. But with interest rates at record lows, it's never been more important to find the most efficient and effective way of making cash allocations.

Advisers will be well aware that term deposits pay a higher level of income than at-call accounts, but will also know that investors are forced to lock away their cash for a specified period, limiting their ability to access funds for emergencies or to take advantage of strategic investment opportunities.

With continued innovation in the exchange traded fund (ETF) market, it is now possible to make allocations to cash at higher interest rates than those available from alternative at-call options (and, in fact many term deposits), without incurring duration risk.

Cash ETFs provide a simple and transparent solution for investors and their advisers who are looking for a combination of market-leading rates and accessibility, and can be bought and sold like any share on the Australian Securities Exchange (ASX).

How does a cash ETF work?

There is just one Cash ETF currently available on the ASX. Managed by BetaShares, it aims to generate a return that exceeds the Reserve Bank of Australia (RBA) cash rate, with income distributions paid monthly.

"We have spent a considerable amount of time speaking to financial advisers and clients and one thing that stood out is that there is an opportunity in the Australian market for a competitive cash offering being available in the form of a transparent, liquid and simple to understand ETF," BetaShares managing director Alex Vynokur[01] said.

The structure of the ETF is very straightforward - it only holds Australian dollars in bank deposit accounts with Australian banks. Currently the ETF has its deposit accounts with four institutions.

Because it trades like any share on the ASX, with the ticker "AAA", holdings in the ETF can be bought or sold at any time during market open without the need for bank account opening or paperwork.

Since its launch approximately two years ago the Fund has grown to be one of the top 10 largest exchange-traded products on the ASX. The main reason behind the product's popularity with advisers is that many of the at-call cash options included on platforms commonly used by advisers only provide the RBA rate (or less) on cash balances.

For example, as at 31 December 2013, the average interest rate on the default cash options available on the three largest wrap platforms was 2.45% per annum, 5 basis points lower than the official RBA rate. However, at the time of writing, the rate on the BetaShares Australian High Interest Cash ETFs' cash deposits (after fees) is 3.45% per annum.

"Generally for financial advisers and their clients, the default cash option is the one available through investment platforms. The top three platforms are offering interests rates around the official RBA rate of 2.5%. We have seen a disconnect between the pricing that's available to advisers and their clients via platforms and what's available directly on the retail market," said Vynokur.

A cash ETF can therefore potentially boost returns on client cash holdings by as much as 1% above default alternatives, without incurring any duration or capital risk, and with availability on a number of the major platforms. Extra returns on cash holdings becomes especially important when you consider the impact of inflation. With the official inflation rate at 2.7%, that additional 1% could mean the difference between generating net losses (after inflation) and generating a real return.

What other options are there for cash?

Of course, there are other cash options available that also achieve some of these aims.

For example, most banks provide an at-call savings account linked to a client's everyday account, which enables easy access to funds as well as generating a return on the client's cash holding.

The downside of these accounts is that they will often have an introductory interest rate that then falls back to RBA-level rates over time.

Term deposits are another alternative to at-call accounts that often provide investors with interest income above the cash rate, as long as the investor is willing to lock their funds into the account for a set period.

In a falling interest rate environment term deposits can be a good option for clients' cash holdings, as they allow a guaranteed return over the pre-determined time period.

The quote

There is an opportunity in the Australian market for a competitive cash offering being available in the form of a transparent, liquid and simple to understand ETF.

However, they also incur potential break fees or forfeiting of interest if the money is accessed before the maturity date.

Perhaps most importantly though, at least with current market dynamics, the interest rates achievable via term deposits may in fact be lower than is currently being achieved on the ETF.

As at December 2013, the current average one-year term deposit rate from the big four banks was 3.3% per annum and the average high interest savings account 'base rate' from those banks (once the honeymoon rate elapsed) was 2.5% per annum.

The gap between the two rates demonstrates the previously mentioned trade-off – between higher returns and accessibility of funds – between these two main forms of cash holdings.

A cash ETF provides investors with an efficient third option for cash exposures. Where cash ETFs differ from an at-call account is the opportunity to provide higher returns, while still providing access and liquidity to funds when compared with a term deposit.

Since inception the cash ETF has generated 95 basis points above the RBA cash rate and almost 1% higher than what is available as the default at-call cash option on investment platforms.

A cash ETF can be bought and sold on the ASX like any share, using the ticker AAA, with settlement taking place three days after the trade date.

Investors should be aware that customary brokerage will be payable on transactions. Interest is paid out monthly and there is an income reinvestment plan available for those who want it.

If you are looking for a cash solution for your clients providing higher yields than those currently obtained by the average at-call bank savings account, combined with the flexibility of accessing the funds as easily as selling any share on the ASX, the BetaShares Australian High Interest Cash ETF may well be the right fit for your client's portfolio. FS