

As Australia's leading liquidity manager, we often find our cash fund offerings compared against bank term deposits. In this piece, we seek to evaluate the relative merits of each of these cash investment strategies, comparing returns from our First Sentier Cash Fund with those of a typical term deposit investor over the past 6 years. This period is well suited for this type of analysis, as it includes a several instances of risk-market weakness, and overnight cash rates spanning 0.10% to 4.35% (it also happens to coincide with the launch of the fund!).

To begin, let us overview the broad characteristics of the two different cash strategies in question.

Strategy	Term Deposit Strategy	First Sentier Cash Fund
Description	12-month rolling term deposits with Australian Major Banks. Fixed interest rate at inception with steady return profile.	Investment in the First Sentier Cash Fund; a highly liquid investment vehicle with exposure to high-quality money market securities, bank deposit product, and floating-rate notes.
Liquidity	Somewhat illiquid - cash at maturity or with 31-days' notice, with an interest penalty.	Daily liquidity t+1.
Return	Long-dated term deposits may outperform cash funds in falling interest rate environments, or in challenged credit environments. Bank regulation incentivises competitive pricing of retail deposits, however banks are also known to take advantage of investor inertia with teaser rate strategies.	May outperform term deposits in rising interest rate environments, or alongside favourable credit conditions, and is typically quicker to adjust to changing interest rate settings. Manager has flexibility to take advantage of different security types and funding conditions as they arise.
Risk	No market-to-market volatility: term deposits are typically valued on a straight-line accrual basis, with the interest rate applicable for the life of the deposit known ahead of time. Small deposits benefit from the Financial Claims Scheme's \$250,000 deposit guarantee, with larger deposits above this amount subject to credit risk.	Very low mark-to-market volatility: cash funds, and indeed cash benchmarks, do exhibit a small level of volatility as tradeable money market instruments are revalued daily. A bank 'negotiable certificate of deposit' will revalue based on changes in interest rates, whereas a term deposit issued by the same institution will not 'see' this volatility. Investments in the First Sentier Cash Fund are typically very highly rated (A1+/AAA short-term/long-term average rating); however these investments are subject to credit risk. See Figure 2 for a total return comparison of both strategies.
Diversification	Typically concentrated with a small number of counterparty banks.	Higher level of diversification and security breadth compared to most term deposit strategies. Manager is empowered to alter the underlying investment mix through time to take advantage of different opportunities.
Administration	Can be onerous to 'shop around' and maintain an ongoing book of term deposits facing different counterparties.	Singular cash strategy available on all major investment platforms; SMA-friendly liquidity option.

Having reviewed the broad characteristics of each approach, let us construct a term deposit return series to complete our analysis. Taking data from the RBA's Advertised Deposit Rates tables¹ – we model a typical term deposit investor, rolling a series of 12-month term deposits on a staggered basis at 6-month intervals. With this schedule, we construct a total return series and compare this to the net return outcomes seen in our flagship First Sentier Cash Fund. These returns outcomes are illustrated in Figures 1 and 2.

¹ Source: 'Advertised Deposit Rates – F4', <https://www.rba.gov.au/statistics/tables/>. "Figures for 'banks' term deposits', where available, are averages of the five largest banks' rates."

Figure 1 - Return Analysis

Return Analysis

FSI Cash Fund vs Term Deposit Strategy

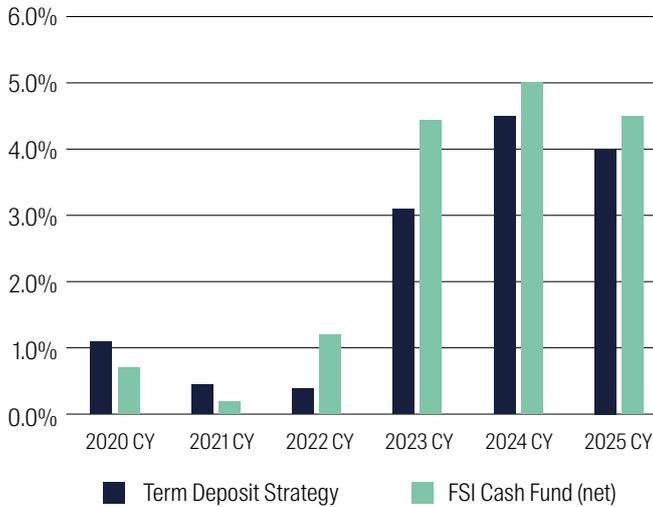
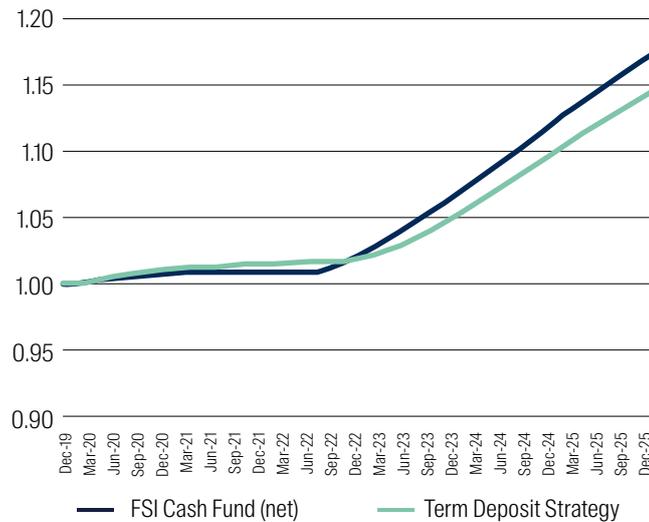


Figure 2 - Total Return Analysis

Total Return Analysis

FSI Cash Fund vs Term Deposit Strategy



We can draw a number of observations from this analysis:

1. The Term Deposit Strategy and the First Sentier Cash Fund offered similar return outcomes over the analysis window, with the First Sentier Cash Fund offering slightly better outcomes overall.

a. Term deposits performed well in the early stages of the pandemic and during the zero-interest rate period of 2020-2022, as emergency liquidity support provided unlimited funding to the local banking sector, to the detriment of traditional institutional investors. The 12-month term deposit locked in at the beginning of the period (31/12/2019) also provided a return buffer as interest rates fell, demonstrating one of the advantages of this strategy in falling rate environments.

b. The First Sentier Cash Fund performed better as interest rates normalised, as it adjusted more quickly to changing levels, and subsequently benefited from normalised credit and funding markets. The First Sentier Short Term Investments team were also able to take advantage of their scale and relationships to secure better yielding investments in this period, as banks sought to re-establish funding with the institutional market away from the emergency liquidity conditions they had become used to.

2. Whilst the First Sentier Cash Fund does exhibit low levels of volatility compared to the relative certainty of the Term Deposit Strategy, its returns remained remarkably stable throughout historically volatile periods such as the COVID pandemic, or the normalisation of interest rates and credit spreads in 2022.

3. It is of course important to note the biggest difference between the two strategies – liquidity. The First Sentier Short Term Investments team regularly facilitate billions of dollars of daily transactional liquidity as the largest cash manager in Australia, including throughout extreme periods such as the early days of the COVID pandemic. Our focus on deep relationships with the strongest, most liquid counterparties protects what is arguably the most important characteristic of cash investing – liquidity. Whilst term deposits do offer limited liquidity at specified windows, they do not offer the flexibility that daily liquidity provides.

To requote our opening line - cash investment focusses on three objectives: capital stability, liquidity, and income. Within these objectives, term deposits and cash funds both have a role to play, with different characteristics and advantages. Hopefully this analysis helps illustrates the difference between the two approaches, and helps the reader determine the best approach for their own circumstances.

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