Cash

Major Trends

The return of yield: Cash is once again a competitive asset class. Based on the yield of 1-year government T-bills, a proxy for expected average cash yield over the next 12 months, investors can expect to earn something close to 5.0% in USD and GBP and 3.5% in EUR cash deposits in 2024, although this is a variable rate and subject to change.

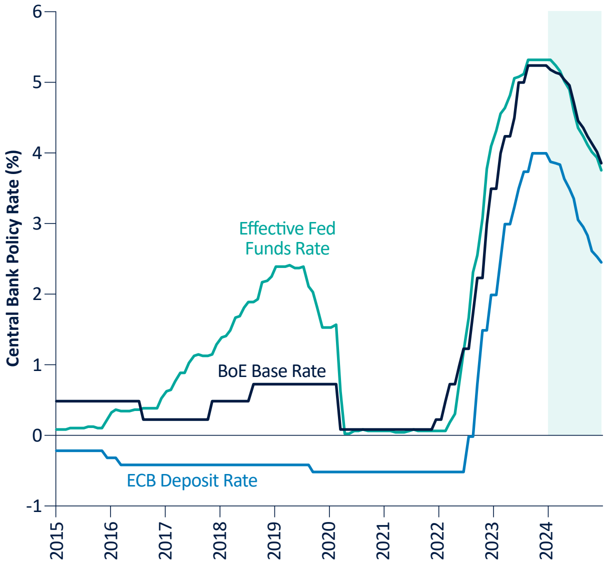
An end to the hiking cycle: Developed market central banks are likely to start lowering interest rates in 2024. Overnight interest rates are expected to decline by just over 1% in 2024 across USD, GBP and EUR. In USD, this would take the effective Fed Funds rate down from 5.3% at the start of January to c. 4% by the end of December, as shown in Exhibit 1. Our expectation is that central banks will cut interest rates at a slower pace than the start-of-year consensus, which, for now, favours holding cash rather than longer-dated bonds. However, we expect to reduce the cash allocation in favour of benchmark duration bonds if longer-dated yields rise and the yield curve steepens, or if the economic outlook deteriorates such that central banks may be forced to cut faster.

Golden Rules

- The role of cash is primarily operational, in that a small allocation is necessary to facilitate portfolio management (e.g., meeting capital calls or portfolio withdrawals).
- Cash has a limited investment role in an optimised long-term portfolio as it offers no risk premium for which we expect to be compensated, resulting in a low real return over time.

Exhibit 1

Cash rates are expected to decline from multi-year highs in 2024



Note: *shaded area shows implied path of forward rates over next 12 months. Data as of 16 Jan 2024*

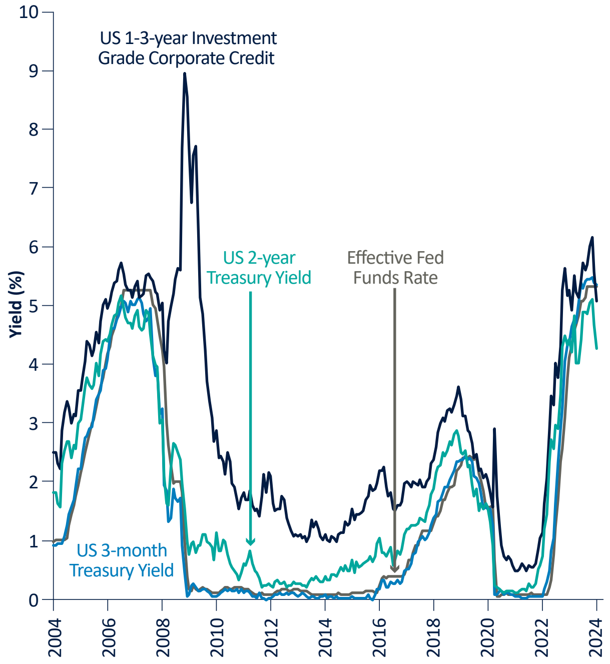
Source: *Bloomberg*

2024 Strategic Priorities

- **Make use of cash-like alternatives with higher yields:** For larger cash allocations we recommend holding short-duration investment-grade bonds (both government and corporate) that represent an acceptable level of risk for roughly 0.5% of additional yield and good liquidity (Exhibit 2).
- **Use cash sweeps and money market funds:** Commercial banks are often slow to pass through higher rates to customers. We have sought to offset this by proactively sweeping excess cash into money market funds or term deposits to earn higher yields.

Cash
continued

Exhibit 2
Short duration credit offers a higher yield, but with higher risk



Source: *Bloomberg. Data as of 31 Jan 2023*

Long-Term Expected Return

Exhibit 3
Based on our 10 year forecasts, we target the following long-term expected return for Cash

	Cash
Risk-free Rate	4.0%
Risk Premium	—
Illiquidity Premium	—
Manager Alpha	—
Total Return	**4.0%**

The risk-free rate and expected return for Cash represent the average forward cash rate in USD over the next 10 years (as of 31 Jan 2024)

Hypothetical return expectations are based on simulations with forward looking assumptions, which have inherent limitations. Such forecasts are not a reliable indicator of future performance.