Russell Investments

# Added value by putting your cash to work

One of the easiest and most consistent sources of return potential is to reduce unrewarded exposure to cash. This case study looks at how a pension fund generated extra returns over the long term simply by avoiding cash (return) drag on its large cash holdings.

CUSTOMISED PORTFOLIO SERVICES

CASH SECURITISATION

## The organisation

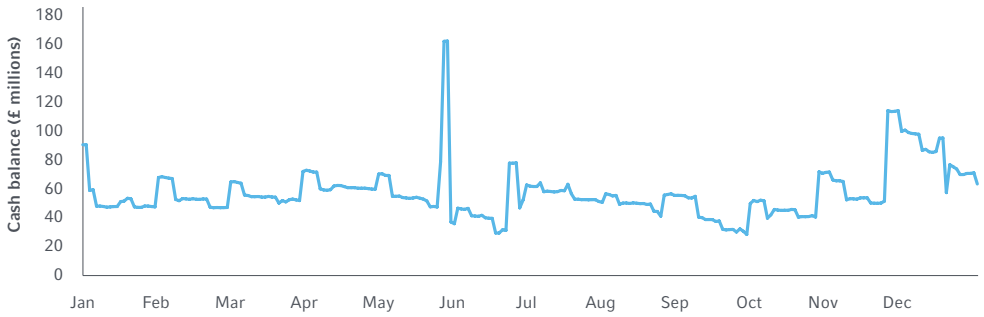
One of our clients, a large corporate UK pension scheme, has a strategic asset allocation of approximately 70% equities and 30% bonds. The scheme did not have a strategic allocation to cash but was often exposed to a large cash balance due to uncertainties of upcoming cash requirements (e.g. for capital calls or benefit payments) and fluctuations in realised gains and losses (e.g. from currency hedging strategies). Figure 1 illustrates the cash exposures for 2014, showing an average holding of £58 million. In some cases, the amount exceeded £130 million as the scheme underwent periods of change.

## The challenge

The trustees understood that cash was necessary to provide the short-term liquidity they needed for operational requirements, but over the long term they realised that cash would drag down the performance of the scheme. For example, an average cash holding of £58m would have cost the scheme roughly £1.5m on average annually over the last 10 years and, due to the recent low-yield environment, over £4m on average annually in lower performance over the last five years.[1]

The trustees sought a solution that could improve long-term performance without reducing their ability to meet variable cash requirements.

**Figure 1 – The scheme's cash exposures during 2014**




Source: Russell Investments. For illustrative purposes only.

1. Calculations as of 31 December 2014, assuming an average cash position of £58 million each year and that the asset allocation was the same as their current equitisation allocation. Annual performance potential is estimated as returns less potential cash interest over each time period.

**Figure 2 – Five-year cumulative performance for cash acquisition**


Source: Russell Investments. For illustrative purposes only. Date 1 Dec 2009 to 31 Dec 2014, gross of fees.

## The solution – cash 'equitisation'[2]

The trustees employed Russell Investments to implement a cash equitisation programme to gain the desired yield-enhancing market exposure – in this case, to the long-dated UK gilt market. Russell monitors the cash balance daily and adjusts the position as necessary – ensuring that cash is put to work.

As the programme only requires a small amount of cash for margin deposits, the rest is available to meet liquidity requirements.

The trustees saw the solution as more effective than purchasing UK bonds directly, and then selling when they needed the cash. They perceived a physical-holdings approach to be much less nimble and much more costly to transact than the derivatives overlay solution. Furthermore, implementing the derivative trades through a third-party specialist allowed them to reduce operational risk and to focus their time on more pressing issues.

## The outcome

Over 2014 the programme generated approximately £8.4 million extra on the cash holdings. Over a five-year performance period, cumulative returns totalled £18.5 million as highlighted in the above chart. Of course, the trustees understand that in some market conditions the programme will make a loss – as experienced over 2013 – but they believe that in the long term, this strategic solution will generate excess returns.

### *A flexible platform for future needs*

Putting cash to work through cash equitisation provides the base for many of Russell Investments' risk- and exposure-management solutions. The flexibility of the platform allows clients to access market exposure while keeping cash available for operational requirements of the scheme. From this foundation, pension schemes are then able to further enhance their ability to manage exposures at a total scheme level – whether it be adjusting for over or under weights from strategic asset allocation or implementing a scheme-level de-risking event.

2. We use a common interpretation of the term 'equitisation' to indicate gaining exposure to non-cash markets using derivatives rather than gaining exposure to equity markets alone.

**For more information speak to:**

**Nicki Ashton,** Head of Strategic Partnerships on (02) 9229 5521 or email **nashton@russellinvestments.com**

### Important Information