Flight to quality

KATHLEEN HUGHES OUTLINES THE LATEST SHORT-TERM INVESTMENT TRENDS REVEALED BY THE ANNUAL JPMORGAN ASSET MANAGEMENT GLOBAL CASH MANAGEMENT SURVEY.

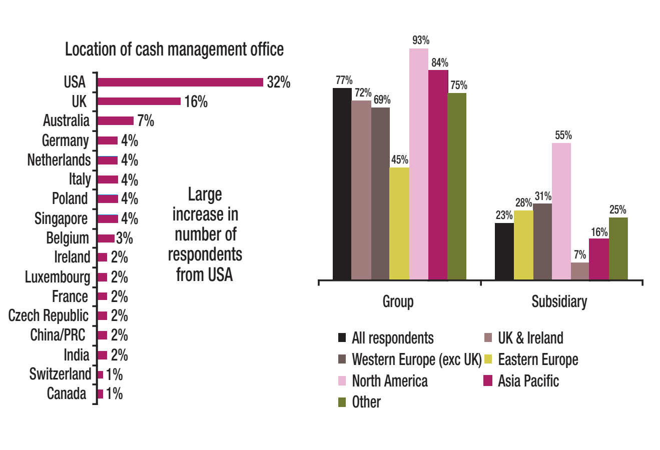
The annual JPMorgan Asset Management Global Cash Management Survey is now complete. It is the 10th edition of the survey, which has been providing a benchmark for the identification of cash management trends among treasurers since its launch in 1999.

The survey was conducted in association with the ACT, and valuable support also came from the European Association of Corporate Treasurers (EACT) and, for the first time, the Financial & Treasury Association (FTA) of Australia.

Once again we had a high number of responses, with 314 treasurers around the world providing their feedback. This focus on international responses helps to make the JPMorgan Global Cash Management Survey a truly global barometer of cash management trends.

BROAD RANGE OF RESPONDENTS The survey has seen its respondent group become increasingly diversified over the years. This year an impressive spread of respondents covered a wide range of

Figure 1: Location of cash management office



Source: Q1.12: In which country is your office located? Q1.9: Please indicate whether you are responding on behalf of a group or subsidiary.

Executive summary

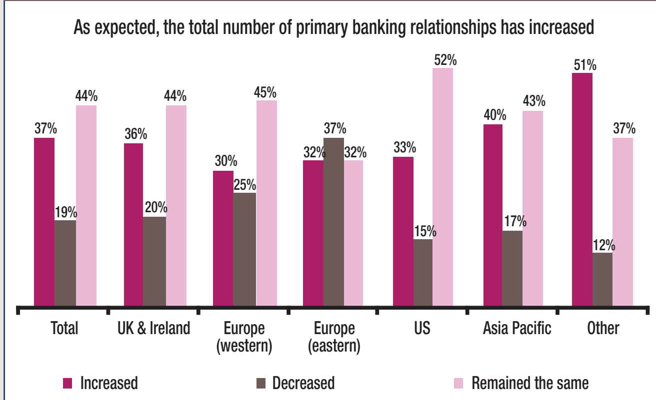
- Given the events of the last year it is not surprising that the trends that stood out in the annual JPMorgan Asset Management Global Cash Management Survey were an increased concern over risk and an increased treasurer focus on credit quality. The credit crisis and resulting credit risk have replaced last year's key concern of treasury departments over the accuracy of cash forecasting. As funding questions loom, treasurers have also increased their focus on liquidity and managing cash positions, reflected in the fact that treasurers are expanding the number of banking relationships they maintain.

regions and markets (see Figure 1), from China to South America. The proportion of respondents based in the US continued to rise, and this group now represents almost a third of respondents. Responses from Asia Pacific also grew, amounting to 15% of the overall sample for the first time.

Respondents also represented companies and organisations from many different sectors and industries, and from across the market capitalisation spectrum.

By market capitalisation, the largest group of respondents (42%) came from mega-cap organisations with a market capitalisation of more than $5bn, while 38% represented large-cap organisations with a market cap of between $500m and $5bn. We saw an increase in small-cap responses this year, with 20% of respondents representing smaller companies, up from 14% in the 2007 survey.

Figure 3: Number of banking relationships by region



Source: Q2.2: Has the total number of bank relationships you have increased, decreased or stayed the same over the last 12 months?

DELVING DEEPER INTO CASH MANAGEMENT ISSUES The survey questions remained largely the same as in previous years, so that useful comparisons can be made, although the format and subjects covered continue to evolve. As usual, the survey questions delved into all areas of the treasury cash management function, including banking relationships, how surplus cash is invested, how cash investment management providers are selected and what expectations treasurers have for returns.

Some of the responses to these questions are discussed in more detail below. However, some trends that stood out were an increased concern over risk and a greater treasurer focus on credit quality.

TIMING OF THE SURVEY The survey was open from 1 July to 7 October 2008. However, most respondents completed the survey before the dramatic events in the banking sector in mid-September. Nonetheless, we found that responses reflected marked changes in the attitudes and expectations of treasurers, as the turmoil in the credit markets and the developing banking crisis contributed to rising risk aversion. If the survey was conducted again now, these changes could be even more pronounced.

RISING RISK AVERSION After a tumultuous year in money markets, a major theme of the survey was, unsurprisingly, increased risk aversion. Last year, respondents said that the key concern of treasury departments today was cash forecasting accuracy. This year, only 10% listed accurate cash forecasting as their key concern, as more immediate worries have presented themselves.

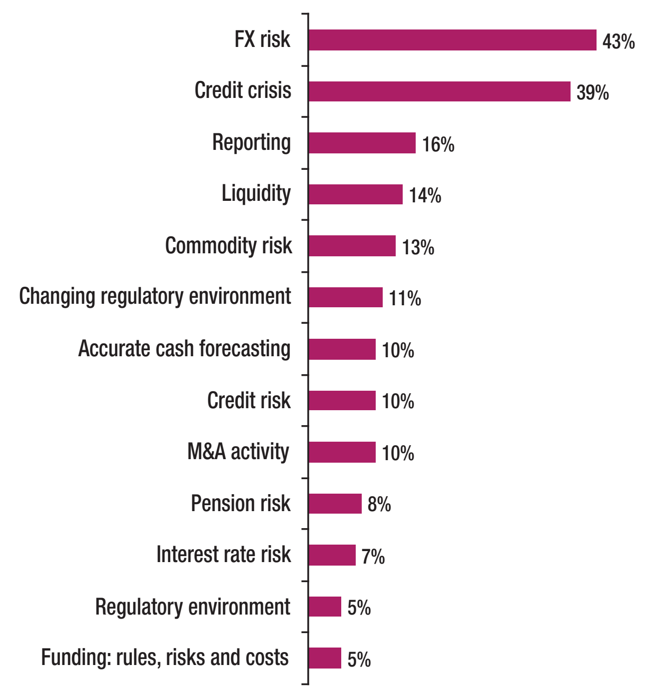
Unsurprisingly, the main concern for treasurers is now the credit crisis and resulting credit risk (see Figure 2).

In addition, foreign exchange risk was mentioned as an important concern by 43% of respondents this year. This may reflect the dramatic currency movements witnessed in recent months and also the extreme uncertainty over global interest rates witnessed in the summer, when central banks seemed to be treading the finest of paths between the devil of higher inflation on one side and the deep blue sea of slowing growth on the other.

Treasurers have also increased their focus on liquidity, which was the most cited concern about managing cash positions. This concern is perhaps reflected by an increase in the number of banking relationships maintained by treasury departments (see Figure 3).

Until last year, the annual survey had demonstrated a gradual

Figure 2: Concerns in the treasury department



Source: Q10.4: What are the most important concerns in your treasury department today?

trend towards fewer banking relationships. However, last year's survey showed a reversal of this trend, which has continued this year, with the majority of respondents either increasing the number of banking relationships or keeping them the same. High-profile bank collapses have perhaps prompted cash managers to spread their net wider to diversify risk. While the increase in government guarantees for cash deposits has undoubtedly provided some measure of reassurance, treasurers are unlikely to want to risk the liquidity problems that would ensue if they were forced to wait to claim their money back from regulators.

FLIGHT TO QUALITY A result of the heightened concern over risk appears to have been an increased focus on security, with survey responses reflecting the wider flight to quality witnessed in markets this year. Almost half of treasurers said they had significantly changed their approach to credit ratings and counterparty risk over the year, in response to the credit crisis.

Treasurers are demanding notably higher credit ratings for their cash investments. The number of respondents able to use sub-investment grade assets has dwindled to almost zero across the board (see Figure 4).

Pooled fund investors were the most security-conscious, with almost half of pooled fund users saying they only invest in funds with AAA ratings, but there was a shift up the credit rating scale for all three investment types. Continuing the trend seen last year, the proportion of treasurers permitted by their investment guidelines to invest directly in money market instruments fell.

In addition, the survey showed an increased frequency of credit rating monitoring, reflecting the surge in credit rating downgrades over the year. While 32% of respondents in 2007 monitored credit ratings only at the point of investment, 81% now perform regular scheduled reviews, with 65% reviewing ratings on at least a quarterly basis. Smaller companies remained the least likely to carry out regular monitoring of credit ratings, but while 61% of small companies checked ratings only at the point of investment in 2007, the proportion fell to just 26% this year.

CONTINUED FOCUS ON YIELD Despite their increased concern over risk and preference for high-quality investments, treasurers continue to target high yields. The proportion of respondents seeking Libor+ (the London InterBank Offered Rate plus a specified percentage) returns from their short-dated surplus cash increased for all three investment types (see Figure 5).

However, the risks that treasurers are prepared to take to gain this yield have changed since the beginning of the credit crisis. Respondents seeking higher yields have become increasingly willing to take on additional duration risk, perhaps to compensate for their growing reluctance to take on foreign exchange and credit risk.

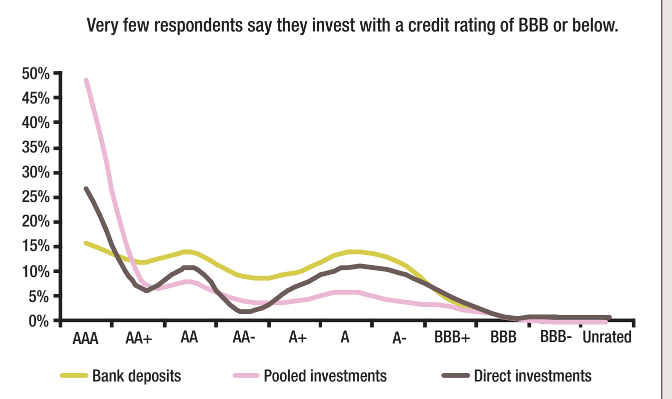
Furthermore, when questioned about investment timing, 75% of respondents indicated that they would be willing to consider an earlier cut-off time if it meant delivering a higher yield.

THE FUTURE We asked treasurers to tell us what they think the main developments in cash management will be over the next five years. By a significant margin, the most popular response was an increased trend for outsourcing. This may again be a response to increased concern over risk. The events of the credit crisis have built a much more complex world for treasurers to navigate, and it seems that they foresee an increased reliance on outside assistance.

FOR MORE DETAILS As you can see from this brief overview of this year's results, the JPMorgan Asset Management Global Cash Management Survey again contains highly useful insights and observations into the current state of the global cash industry. The findings discussed here constitute just some of the key results from the survey. A full version of the report can be found on the ACT website and the JPMorgan Asset Management global liquidity website. A printed copy can be obtained by contacting Kathleen Hughes by phone (+44 20 7742 6059) or at the email address below.

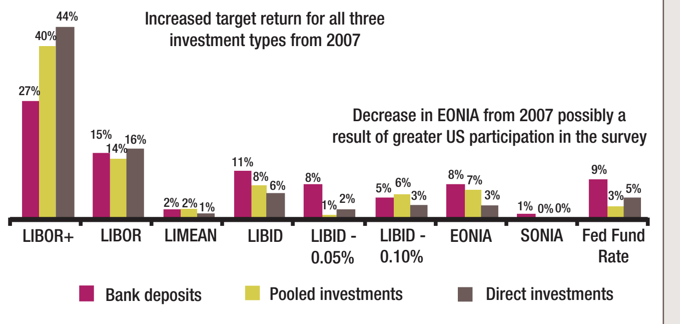
Kathleen Hughes is head of global liquidity EMEA at JPMorgan Asset Management.
kathleen.hughes@jpmorgan.com
www.jpmgloballiquidity.com

Figure 4: Minimum credit ratings required



Source: Q5.4: What is the minimum credit rating you would need?

Figure 5: Target returns of short-dated surplus cash



Source: Q5.6: What returns do you aim to receive from your short-dated surplus cash?

THE EVENTS OF THE CREDIT CRISIS HAVE BUILT A MUCH MORE COMPLEX WORLD FOR TREASURERS TO NAVIGATE, AND IT SEEMS THAT THEY FORESEE AN INCREASED RELIANCE ON OUTSIDE ASSISTANCE.