CASH MANAGEMENT LANDSCAPE

RATES AND REFORM LEAD TO A SEA CHANGE

SAGE
INVEST WITH WISDOM™

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Over the last two years, a dramatic shift has taken place in what is typically the least dramatic allocation within a client's investment portfolio. The cash management landscape has shifted from an environment of persistently low rates to one where differentiated investment alternatives present opportunities for investors to make more from their cash allocation.

Two events have led to this shift. First, Money Market reform, which introduced the potential for redemption fees and liquidity gates, has pushed many investors from Prime Money Market to Government Money Market funds. Second, interest rates have moved meaningfully higher on the front end of the yield curve. While Government Money Market funds have certainly benefited from higher rates, Prime funds offer a significant yield advantage over Government Money Market funds.

A custom cash management strategy implemented in a separately managed account, such as the Sage Cash Management Strategy, offers investors the diversification and yield advantage of Prime Money Market funds without the structural challenges of redemption fees and liquidity gates.

In this piece, we explore the cash management landscape and why custom cash management is more attractive than it has been in years.

MONEY MARKET REFORM

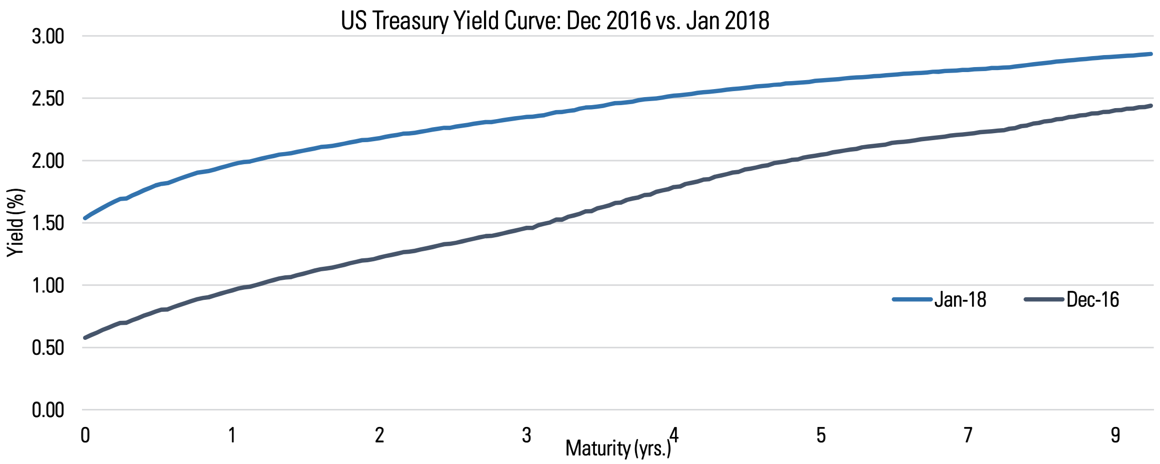
Following the 2008 Financial Crisis, there was an outcry for greater regulation across many corners of the financial industry. During the crisis, several Money Market funds, long hailed as undeniably safe instruments, saw their net asset value fall below the key level of $1.00 per share as investors panicked and rushed for the exits all at once. The phenomenon, known colloquially as "breaking the buck", caused widespread consternation amongst Money Market investors.

To avoid "breaking the buck" in the future, the SEC recommended a set of rules that were finally adopted in late 2016. These rules, which include the potential for liquidity fees and redemption gates, are designed to protect the investors of certain types of Money Market funds, specifically Prime funds. Prime funds invest in both corporate and government debt. Their cousins, Government funds, invest only in instruments that are backed by the US Government.

Since Government funds weren't deemed to be as risky as Prime funds, the new regulations did not apply to the Government funds. Consequentially, fear and frustration sparked by Money Market reform caused approximately $1 Trillion* of investor money to shift from Prime Funds to Government Funds since the beginning of 2016. Unfortunately, this has meant the realized yield on Money Market investments decreased dramatically and cash management portfolios have become less diversified.

WHEN RISING RATES ARE A GOOD THING

Following the 2016 regime change in Washington, short-term interest rates have risen dramatically on an absolute basis and relative to the rest of the US Treasury curve. While the yield on a 2-year US Treasury note increased from around 1.20% on 1/01/2017 to 2.16% on 1/31/2018, the yield on a 10-year Treasury note only increased 0.4% over the same period. To put the 2-year yield increase into context, the yield on a 10-year Treasury note traded through 2.10% at this time last year.



Source: Morningstar Direct, Bloomberg

What does this mean for cash investors? The table below compares the current yields of Government Money Market funds, Prime Money Market funds, and the Sage Cash Management Strategy to yields at the end of the last 3 calendar years. Not only does this illustrate the broad improvement in yields for cash investors, it also shows the magnitude of difference the Sage Cash Strategy can provide over a government-only approach.

Yields Comparison: Cash Management Strategies

	Gov't MM Fund	Prime MM Fund	Sage Cash Management
12/31/2015	0.01%	0.10%	1.97%
12/31/2016	0.26%	0.44%	1.65%
12/31/2017	0.76%	1.10%	2.01%
1/31/2018	0.77%	1.11%	2.19%

Source: Bloomberg, Morningstar Direct

As of 1/31/18, the Sage Cash Management Strategy provided a yield of approximately 2.19%, more than 140 bps above the typical Government Money Market fund. That means a company with $200M of "non-operating" cash can generate an additional $2.5M per year to fund plant expansions, pay down debt, or return money to shareholders.

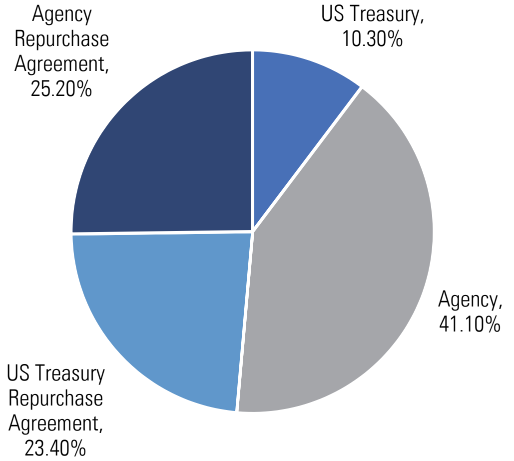
By investing in a wider variety of income producing assets, rather than only focusing on government-issued debt, the strategy also decreases the sector specific risk inherent in most Money Market funds. Government-issued securities will perform worse during a period of rising interest rates than corporate or asset-backed debt of similar maturity, and so diversification of asset classes can decrease overall risk to the institutional investor's portfolio. And, while many fixed income investors fear the negative impact of rising rates, the mechanics of short-term fixed income portfolios allow investors to enjoy the benefits of higher yields with minimal principal volatility.

Even with nearly 1% rise in 2-Year Treasuries from 1/01/17-1/31/18, the Sage Cash Management Strategy experienced a positive gross cumulative return of 1.55% over the same period.

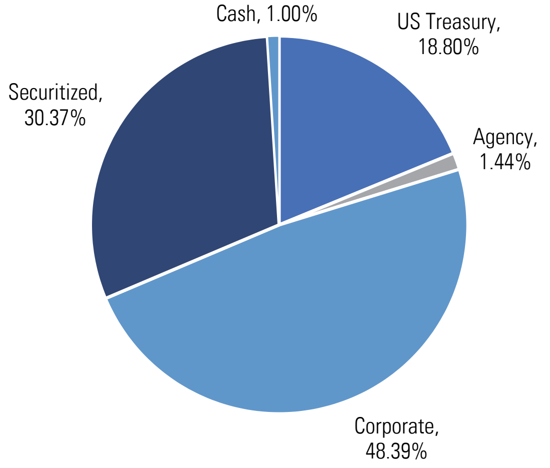
THE SAGE CASH MANAGEMENT STRATEGY

The Sage Cash Management Strategy serves the operating cash needs of corporations, healthcare institutions, insurance companies, municipalities, as well the endowment and foundation community. The goal of this strategy is to take advantage of the inefficiencies within the short-end of fixed income markets. Sage's strategy uses a blend of US Treasuries, Agency notes, high-grade Corporate bonds, and high-grade Asset Backed Securities to create a diversified mix of high quality fixed income instruments. The strategy, through credit diversification and a modest duration extension, is designed to provide superior yield compared to Government Money Market funds while maintaining the highest levels of liquidity. In addition, the exposure to a wider variety of bond sectors makes the portfolio more diverse and less prone idiosyncratic risks.

Sample Government Money Market Fund Allocation



Sage Cash Management Sample Allocation



Source: Bloomberg, Morningstar Direct, as of 12/31/2017

- **Credit Risk:** In the context of cash management, managing credit risk means making sure portfolios do not experience outsized volatility. Currently, Sage's Cash Management Strategy maintains an average credit quality of A2 using Moody's scale, which implies an average risk well within the least risky area of the risk spectrum.
- **Interest Rate Risk:** With a duration of approximately 0.5 years, Sage's Cash Management Strategy has relatively low interest rate sensitivity. The Sage investment team will position bonds across the short-term yield curve. During periods of rising rates, maturing bonds reinvest at higher rates, offsetting the negative impact that rising rates can have on bond prices.

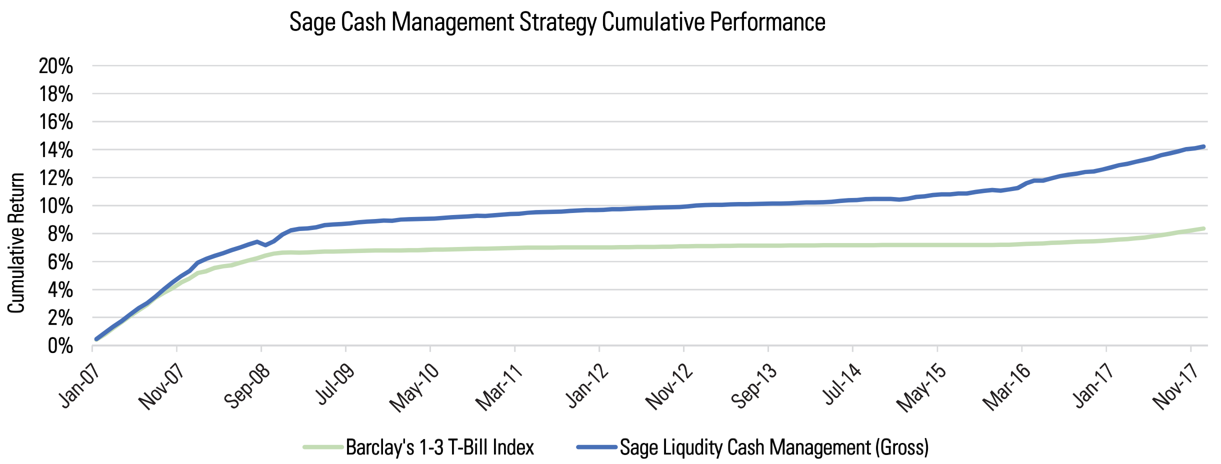
WHAT ABOUT THE RIDE?

As illustrated below, since the beginning of 2007, the Sage Cash Management Strategy has consistently delivered positive returns throughout many unique market environments. As the table below illustrates, the single worst monthly return over the past 11 years was -24 bps and the worst rolling three-month period had a return of -3 bps.

	Rolling 1 Month	Rolling 3 Months	Rolling 6 Months
Total Periods	132	130	127
Down Periods	6	1	0
% Down Periods	4.55%	0.77%	0.00%
Worst Period	-0.24%	-0.03%	0.05%
Best Period	0.57%	1.45%	2.80%

Source: Sage, Gross Returns from 1/01/2001-12/31/2017

And, for investors who can live with these very rare periods where there is a small draw-down, the long-term cumulative performance has been rewarding. As noted in the illustration below, the cumulative performance since 2007 was 14%, almost 6% higher than the Government only 1-3 month T-Bill index. Apply that difference to a significant cash balance and you've greatly improved the operating efficiency of any organization.



Source: Bloomberg

WHAT IF INTEREST RATES CONTINUE TO RISE?

The following table is an illustration of how the Sage Cash Management Strategy, based on holdings as of 1/31/2018, is expected to perform during three different interest rate "shocks". As the table demonstrates, even a large 1% shift up in interest rates would not adversely impact the portfolio over a 12-month time horizon. Since the portfolio is comprised of short duration bonds that are constantly maturing and being reinvested at higher rates, the decrease in market value from even a relatively large move in rates is swallowed up by the high current yield, and the even higher reinvestment yields as older bonds mature and higher coupon bonds take their place in the portfolio.

	Interest Rates			
	Unchanged	0.25% Higher	0.50% Higher	1% Higher
3 Month Return	0.58%	0.51%	0.45%	0.33%
6 Month Return	1.15%	1.03%	0.90%	0.65%

Source: FactSet

CONCLUSION

- Sage's Cash Management Strategy can be customized for the unique operating needs of each client.
- The strategy provides a meaningful yield advantage over Government Money Market funds.
- The Sage solution provides clients with excellent liquidity, most requests for funds can be fulfilled the very next business day.
- Sage's approach of using a high-quality, diverse portfolio lowers overall portfolio risk and allows the Portfolio Managers at Sage to navigate rate movements effectively, as evidenced by the excellent track record of this strategy during even the worst market environments.