FUNDS ON FRIDAY
by Glacier Research

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16 April 2021
Volume 1089

Closure of the Absa Fund – where to next?

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The announcement of the closure of the 25-year old Absa Money Market Fund may have sparked concern amongst clients who have their money invested in money market funds across the industry. This should not necessarily be a cause for concern regarding the validity of a mandate which aims to maximise interest income and preserve capital. Absa has since cited that the reason for closure is centred around the fact that the majority of their Absa bank clients believe that the capital within the Absa Money Market Fund and its associated returns are guaranteed by Absa Bank. Perpetuating this confusion is the fact that Absa clients were allowed to withdraw money from the Fund, treating it like an ATM, or just like a bank account.

A deep pool is best

A money market fund is not a fixed deposit account or a bank call account, where the underlying capital and returns might be guaranteed. Rather, it is a unit trust. A unit trust is regulated as a collective investment scheme and it pools investors' money together, providing an efficient and affordable way to invest in financial markets. The portfolio managers then use the pooled funds to invest in appropriate instruments, given the mandate – these may include assets such as equities, property, bonds and cash. The investors are then allocated a portion of the unit trust in proportion to the amount of money that they have invested.

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The objective of a money market fund is to offer investors with an effective low-risk parking vehicle for their money, by preserving capital while also obtaining interest income higher than one would typically receive in a bank account. It is suitable for investors who have a low risk appetite and a short-term investment horizon of up to one year. A money market fund primarily invests in high-quality, short-term money market instruments with a maturity less than 13 months, an average duration less than 90 days and a weighted average maturity less than 120 days. These limits exist to ensure that the fund is highly liquid and able to satisfy withdrawals at any time. The underlying instruments include, negotiable certificates of deposit, treasury bills and credit issued by government, parastatals, companies and banks.

What are the benefits and potential risks of investing in a money market fund versus a fixed deposit?

Ease of access

There are no lock-up period clauses or penalty fees applied when withdrawing from a money market fund like there are with fixed deposit accounts.

Diversification

This means having one's risk adequately spread instead of placing all of one's eggs in an individual basket. Fixed deposit accounts generally have their investment with a single bank and although the bank does guarantee one's deposit, the investor is exposed to a single counterparty risk (risk of the bank defaulting on payment). In contrast, a money market fund has the risk adequately diversified across multiple issuers, preventing being over-exposed to one bank.

In the world of investing, there is no such thing as a free lunch, and one is always faced with a trade-off between risk and reward. Although the Interest-Bearing Money Market category lies at the lowest end of the ASISA category risk spectrum, there are no capital guarantees, even when investing in money market funds. The risks to be cognisant of are in the form of credit, real interest rate and liquidity.

1. Credit risk

If an underlying issuer of a vested instrument goes bankrupt, although this type of debt would constitute as senior debt, the investor could bear some losses, as seen from the recent collapse of African Bank in 2015 and Land Bank in 2020. While there is a low likelihood of this outcome, given that the types of exposures in a money market fund are mostly in the big four banks, it is not impossible. The mitigating factors are diversification of issuers and underlying instruments, along with credit analysis that attempts to address this to a certain extent.

2. Real interest rate risk

Given that money market funds invest in short-term instruments, their returns follow the short-term interest cycle and whenever official interest rates are lower than inflation, real returns might be negative. In reality, money market rates have tended to outperform inflation and deliver consistent positive real returns. Inflation spikes over the short term might, however, lead to temporary lower real returns, but should recover as interest rates are adjusted upwards to address the higher inflation. So, although the value of the invested capital may not have decreased, the purchasing power would have. This risk is, however, more prevalent in fixed deposit type instruments where returns are fixed.

3. Liquidity

In an extreme situation where a money market fund receives a request for a large outflow, the fund may be forced to sell their most liquid, high-quality paper first and eventually long-dated paper and investors could consequently incur a loss. As mentioned, money market funds invest in shorter-dated, highly liquid instruments, so this tends to be less of a risk for these types of funds. In terms of large liquidations, with proper planning, execution of asset liquidations and sound management of client redemptions, the potential negative impact on investors should be alleviated. Considering that money market funds are mainly exposed to highly liquid bank paper, with relatively low average duration, large withdrawals should be easily dealt with.

Where to next for investors?

Money market funds are great investment vehicles for investors who plan on saving their hard-earned money for shorter term goals. A deposit on a house or car, household expenses, an upcoming vacation, perhaps an imminent wedding, or as a rainy-day fund to cover unexpected short-term liquidity requirements, are some examples of these goals. Whatever your short-term goals for saving may be, one would benefit quite extensively from investing in a money market fund that would generate competitive returns versus short-term interest rates, coupled with the objective of capital preservation and high levels of accessibility to your savings.

On the Glacier platform, clients have the choice from a wide range of money market funds. In addition to this, we offer an innovative Cash Option to access certain low-risk, interest-bearing unit trusts, without having to pay our usual platform fees, offering a very compelling option to park cash over shorter periods of time. From a Glacier Research perspective, we believe that the Glacier Money Market Fund and the Nedgroup Investment Money Market Fund are two compelling alternatives featured on the Glacier Shopping List as examples. These funds are backed by solid investment teams, sound investment processes and philosophies, as well as good track records. They both have a high exposure to the big four banks and are managed in a very conservative manner.

Glacier Research would like to thank Saleh Jamodien for his contribution to this week's Funds on Friday.

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Saleh holds a Business Science degree in Finance from the University of Cape Town (UCT) and has passed both the CFA Level I and FRM level I exam. He is currently a CFA Level II candidate. He started his career at Allan Gray as a client service consultant and joined Glacier Research in February 2019 as a graduate research and investment analyst.