What to know about money market funds

Cash deposits at banks increased substantially during the COVID-19 pandemic as clients built up cash reserves, despite low interest rates. The reasons for this were two-fold – those who held onto their jobs spent less on petrol and entertainment costs and the reality of the pandemic drove home the need for some sort of cash reserve in case of emergencies. Saleh Jamodien, research and investment analyst at Glacier, examines the benefits of money market funds and how they contribute to a diversified investment portfolio.

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.

What are the features of money market funds?

- They present an effective low-risk parking vehicle for money, by preserving capital while also obtaining interest income higher than one would typically receive in a bank account.
- They are suitable for a low-risk appetite and a short-term investment horizon of up to one year.
- They primarily invest in high-quality, short-term money market instruments with a maturity of less than 13 months, an average duration of less than 90 days and a weighted average maturity less than 120 days.

These limits ensure that the fund is highly liquid and allows you to withdraw 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?

1. Ease of access

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

2. Diversification

Your risk is spread instead of placing all of your eggs in one basket. Fixed deposit accounts generally have their investment with a single bank and although the bank guarantees your deposit, you are 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. There are risks associated with credit, real interest rate and liquidity even when investing in money market funds.

3. Credit risk

If the underlying issuer goes bankrupt, the investor could bear some losses, as seen from the collapse of African Bank in 2015 and Land Bank in 2020. Although there is a low likelihood of this outcome, given that the types of exposures in a money market fund are mostly in the large four banks.

4. Real interest rate risk

Whenever 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. Although inflation spikes over the short term might lead to temporary lower real returns, they 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.

5. 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 money market funds. However, with proper planning, execution of asset liquidations and sound management of client redemptions, large withdrawals should be easily dealt with.

The Glacier Money Market Fund

Money market funds are great investment vehicles for investors who plan to save 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, you could 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.

Glacier offers clients the choice of a wide range of money market funds as well as an innovative Cash Option to access certain low-risk, interest-bearing unit trusts, without having to pay the usual platform fees. This provides a compelling option to park cash over shorter periods of time.

The Glacier Money Market Fund is a competitive yielding money market investment with low management fees and maximum security of capital. The objective of the Fund is to maximise interest income while preserving capital and providing immediate liquidity through investment in high-quality money market instruments.

More information on the role of a money market fund in your portfolio, as well as the Glacier options.

This article should be read in conjunction with the Minimum Disclosure Document (Includes additional information in terms of money market funds).

As with all investing, consult an appropriately authorised financial adviser before you take any action. This article does not constitute financial advice.

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