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Why 'cash' took a nosedive

John Collett
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Until about a year ago, many investors mistakenly believed they could earn several percentage points above the cash rate and not be exposed to any additional risk. It has taken the biggest financial crisis since the end of World War II to make it abundantly clear just how wrong this belief was.

Higher returns always mean higher risk. There's no free lunch when it comes to the risk versus return trade-off.

Morningstar data shows domestic bonds were the best-performing asset class over 2008 for the first time since 1992 with all the other types of investments that were somehow considered "defensive" shown to be no such thing.

Last year Australian bonds returned 14.95 per cent while international bonds (with currency risk hedge out) returned 9.21 per cent. These returns are for funds investing mostly in sovereign or government bonds. The best-performing bond fund was Intech's Australian Bonds Trust, which provided investors with 17.19 per cent for the year (Vanguard is the underlying manager). The fund did so well because it invests only in government debt.

Anything outside of this has been hit. Morningstar says the worst-performing credit fund lost 34.57 per cent last year. It wasn't only junk bonds and some mortgage-backed securities that got into trouble. Many mortgage funds and higher-yielding funds have been forced to suspend or to limit redemptions.

But where does this leave cash in the flight to safety? Super funds' cash options weren't immune from a bit of tinkering to spice up returns. While there's confusion over the labelling of investment options, for most people "cash" means precisely that and nothing else.

It now transpires, those who were worried about their retirement savings and switched to "cash" to preserve their capital may be in for a nasty surprise when they discover they have lost money. That is because many cash options invested in what is euphemistically called "enhanced" cash. During the good times they made big returns but when the markets crashed, many of the asset-backed securities, credit derivatives and in some cases, shares, that these cash options were invested in, went backwards.

The health and community care industry fund, Hesta, has a Cash Plus option, which lost 7.9 per cent last year.

Unless members read the disclosure documents or the website, most would not realise that the "plus" meant this option could have 30 per cent exposure to shares with much smaller exposures to direct property, infrastructure and hedge funds.

The Cash Plus option did well during the boom returning 10.7 per cent for the year to June 30, 2007. Hesta's website states that a negative year's return can be expected every 30 years.

Hesta members do not have a true cash option available to them. That is because even Hesta's lower-risk Cash option is partly invested in "enhanced cash products" and has had the occasional negative month.

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In November 2007 the cash option lost 0.2 per cent and it lost 0.4 per cent in September last year.

This lack of a true cash option with many funds is an even bigger potential problem for retiree members who wish to quarantine a year or two's worth of living expenses from risky markets.

Some funds that have enhanced cash options as their only cash options are changing where the money is invested. They are returning to the only true-cash investments, government bonds and bank bills.

Last year, the 1.4 million-member industry fund, AustralianSuper, stopped running its cash option as a cash-enhanced option to invest in true cash.

Warren Chant, co-founder of superannuation researcher Chant West, says any investment with an exposure to shares should not be called "cash".

He says it is misleading, even if it is explained in the disclosure documentation and on the fund's website how the option is invested.

"Many older people go nowhere near the internet and most people do not look at the disclosure documents," Chant says.

This story was found at: <http://www.smh.com.au/articles/2009/03/23/1237656847014.html>