



## LIQUIDITY & YIELD: HOW CASH SEGMENTATION CAN OPTIMIZE CASH HOLDINGS

### OVERVIEW

In the modern financial landscape, effective cash management is crucial for institutions looking to optimize their liquidity while maximizing returns. A cash segmentation strategy, implemented through collaboration with an experienced asset manager, provides a structured approach to managing cash reserves. This article explores how institutions can benefit from such a strategy, the steps involved in the process, and the role of experienced asset managers such as Fort Washington Investment Advisors.

### THE IMPORTANCE OF CASH MANAGEMENT

Cash management is a critical aspect of financial planning for institutions. Efficient cash management can help organizations meet their short-term obligations, invest in opportunities as they arise, and maintain financial stability. Poor cash management can lead to liquidity crises, missed investment opportunities, and suboptimal returns on idle cash.

### IMPACT OF REGULATORY CHANGES: MONEY MARKET REFORM & BASEL III

#### Money Market Reform

The reforms and amendments to the money market industry, particularly following the 2008 financial crisis, have significantly impacted cash management practices. These reforms aimed to enhance the resilience and transparency of money market funds, reducing the risk of runs during periods of financial stress. As a result, institutions have had to adjust their cash management strategies to accommodate the potential for NAV fluctuations and the possibility of restricted access to funds. This has led to a greater emphasis on diversification and a more cautious approach to utilizing money market funds for cash management.

#### Basel III

Also introduced in response to the global financial crisis, the Basel III regulations were designed to help strengthen the regulatory framework for banks with a focus on improving their ability to absorb shocks from financial and economic stress. Key provisions led banks to prioritize holding more liquid assets, impacting their investment choices, and the availability of certain cash management products for institutions.

These regulatory changes have necessitated a more strategic approach to cash management, with institutions increasingly relying on the expertise of asset managers to navigate the complex landscape and optimize their cash holdings.

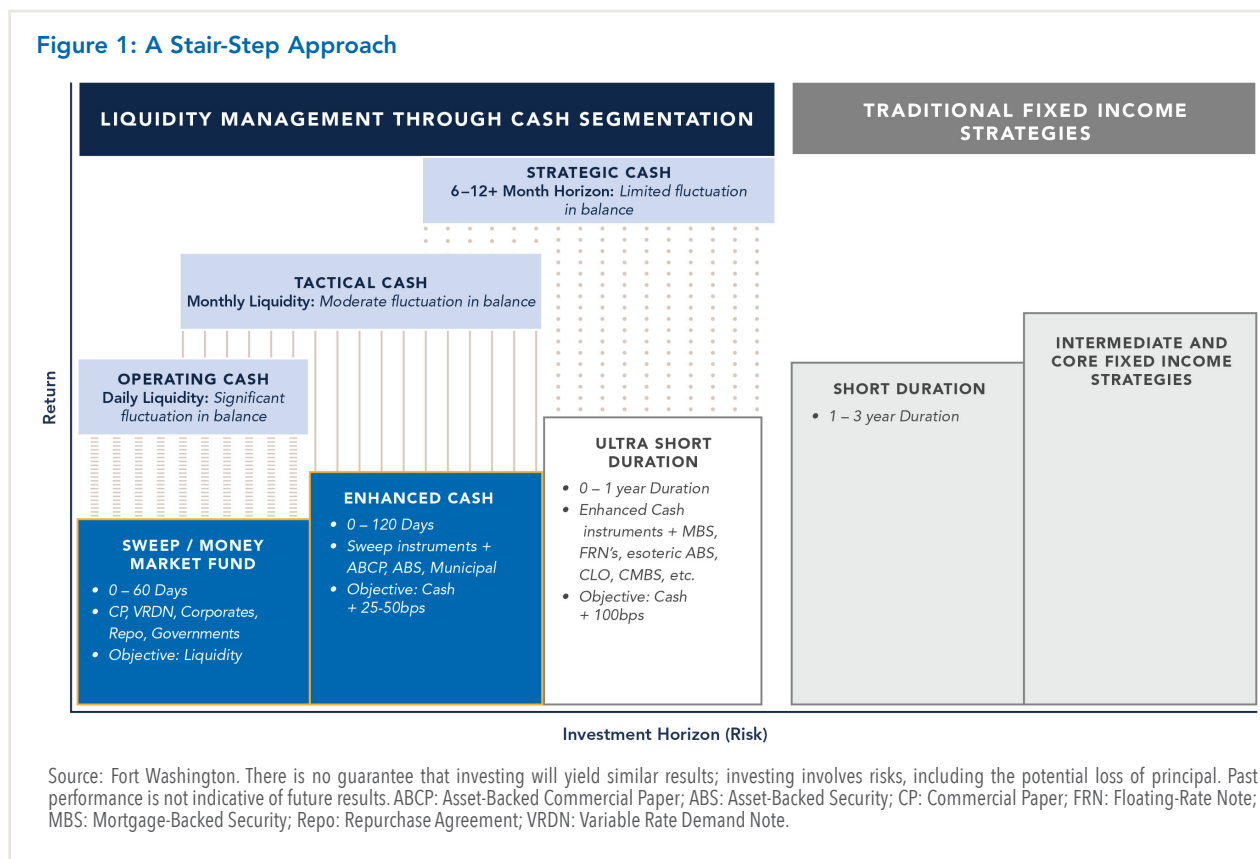
### WHAT IS CASH SEGMENTATION?

Cash segmentation involves dividing cash holdings into different segments based on their intended use and time horizon. An active investment manager can optimize each segment by stepping up and down the return-risk spectrum of short-term market instruments. Each segment is managed according to its specific liquidity needs and risk tolerance.

As shown in *Figure 1* below, our "stair-step" approach defines cash segments in terms of:

1. Operating Cash – This segment covers daily operational expenses and requires minimal risk. Liquidity and capital preservation are paramount.
2. Tactical Cash – These are funds that require adequate liquidity but can be invested in slightly higher-yielding instruments.
3. Strategic Cash – This segment is for somewhat longer-term investments with a focus on higher yields. Liquidity is still a priority, but policy allows for investments in higher-yielding, longer-term assets.

**Figure 1: A Stair-Step Approach**



## THE ROLE OF AN ASSET MANAGER

An experienced asset manager plays a pivotal role in successfully implementing a cash segmentation strategy. Fort Washington's experience managing risk and investing throughout the capital structure allows us to develop optimization strategies for each segment. An elaboration of each segment shown in *Figure 1* follows below as we outline each step in our process.

## FORT WASHINGTON'S APPROACH TO IMPLEMENTING A CASH SEGMENTATION STRATEGY

### 1. Assessing Cash Flow Needs

The first step in implementing a cash segmentation strategy is to assess the institution's cash flow requirements. This involves understanding the timing and magnitude of cash inflows and outflows. Fort Washington works with clients to gather historical cash flow data and project future needs. This assessment helps in determining the appropriate size and allocation for each cash segment.

## 2. Defining Investment Objectives & Risk Tolerance

Once cash flow needs are understood, investment objectives and risk tolerance for each segment are defined. Operational cash will prioritize liquidity and safety, while tactical and strategic cash segments aim for yields corresponding with an incremental increase in risk tolerance.

## 3. Segmentation & Implementation

With the investment objectives and risk tolerance defined, Fort Washington will segment the cash holdings accordingly. The investment strategy is then implemented with the selection of appropriate financial instruments and execution of trades.

As set forth in *Figure 1* above, our "stair-step" approach defines portfolio segments as follows:

### Operating Cash

- ▶ This segment will include sweep and/or overnight investment funds and include high-liquidity, low-risk securities (0-60 Days) such as Commercial Paper, Variable Rate Demand Notes, Government and Corporate instruments as well as Repurchase Agreements.

### Tactical Cash

- ▶ Expanding on overnight funds to include Enhanced Cash instruments, this segment will contain short-to-medium-term investments (0-120 Days) in areas such as Asset-Backed Commercial Paper, other Asset Backed Securities, and Municipal Bonds.

### Strategic Cash

- ▶ This segment builds on Enhanced Cash objectives to include Ultra Short Duration securities (up to 12 months) from asset classes such as Mortgage-Backed Securities, Commercial Mortgage-Backed Securities, Floating Rate Notes, esoteric Asset-Backed Securities, and Collateralized Loan Obligations - among others.

## 4. Monitoring & Reporting

Continuous monitoring of portfolios and understanding the changing dynamics of cash flows are essential to ensure alignment with clients' goals. For this reason, a core tenet of Fort Washington's approach to cash management is effective and regular communication with clients. We strive for a thorough understanding of clients' cash needs and how these needs may change on a real-time basis.

## BENEFITS OF A CASH SEGMENTATION STRATEGY

- 1. Enhanced Liquidity** – helping to make sure funds are available when needed for operational expenses and opportunities.
- 2. Optimized Returns** – potentially increasing yield within cash portfolios without compromising liquidity.
- 3. Risk Management** – balancing risk through continuous monitoring of portfolios, sector diversification, and fundamental analysis of securities.
- 4. Strategic Flexibility** – allowing for dynamic adjustments (stepping up and down the risk spectrum) based on changing market conditions and cash flow requirements.

## SUMMARY

Fort Washington believes there is significant value to be realized by dynamically managing cash assets in a segmentation framework. We recognize that liquidity and safety of principal are paramount when managing cash. This is why we strive for ongoing communication with clients to better understand their needs and expectations. We want to have a thorough understanding of risk tolerance, anticipated investment returns, investment policy construction, and compliance. We work to go beyond what is typically expected of investment managers to help organizations realize the benefits of a tailored cash segmentation solution.

## Learn More About How Fort Washington Can Help

By leveraging Fort Washington's deep organizational experience, clients can spend less time worrying about cash balances and devote more time to managing their business and critical projects. For more information – visit <https://www.westernsouthern.com/fortwashington/investment-strategies/cash-management-solutions>.

## CONTACT

[contactus@fortwashington.com](mailto:contactus@fortwashington.com)

Past performance is not indicative of future results. This publication contains the current opinions of Fort Washington Investment Advisors, Inc. Such opinions are subject to change without notice. This publication has been distributed for informational purposes only and should not be considered as investment advice or a recommendation of any particular security, strategy, or investment product. Information and statistics contained herein have been obtained from sources believed to be reliable and are accurate to the best of our knowledge. No part of this publication may be reproduced in any form, or referred to in any other publication, without express written permission of Fort Washington Investment Advisors, Inc.

©2024 Fort Washington Investment Advisors, Inc.



**Fort Washington  
Investment Advisors, Inc.**

A member of Western & Southern Financial Group

▾ *Uncompromised Focus*®