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Cash is not such a crazy option

In an era of stock market crashes and stalled property sales, RUSSELL EMMERSON finds the upside of cash.

WHEN I was growing up, my grandmother insisted I always carry cash, and underscored the point by pressing a crisp $2 note into my hand.

In my infinite investment wisdom, I spent it on *Star Wars* trading cards with their cheap chewing gum.

It was a fairly stark lesson in hindsight, delivered by a woman who had survived the Great Depression and knew that you needed cash to avoid filling the technical definition of vagrancy.

The same story would have been laughed down a year ago, and the conventional wisdom would have been to sell the trading cards and invest in a share market that was rising and rising and rising.

But in a time of daily share plunges of 5 per cent, and as analysts reach for new ways to differentiate the current volatility from the 1930s, the more conservative cash option is attracting more attention.

NOT AS GOOD AS GOLD

Coloured stretches of polymer are pretty, but lack the hard-edged investment attraction of the gold they once represented. Perhaps most disappointingly, a wad of cash under the bed in the spare room will buy you less when you take it out in one year's time.

But Financial Planning Association state chairwoman Kerrin Falconer said everyone should have ready access to cash for emergencies – just not under the bed.

"For different families it means different things," she said. "I mean $5000 that people could put their hands on easily if your washing machine breaks down, if your fridge breaks down or for medical expenses.

"But it depends on your circumstances – $2000 could be a lot of money for some people."

CASH OR CARRY

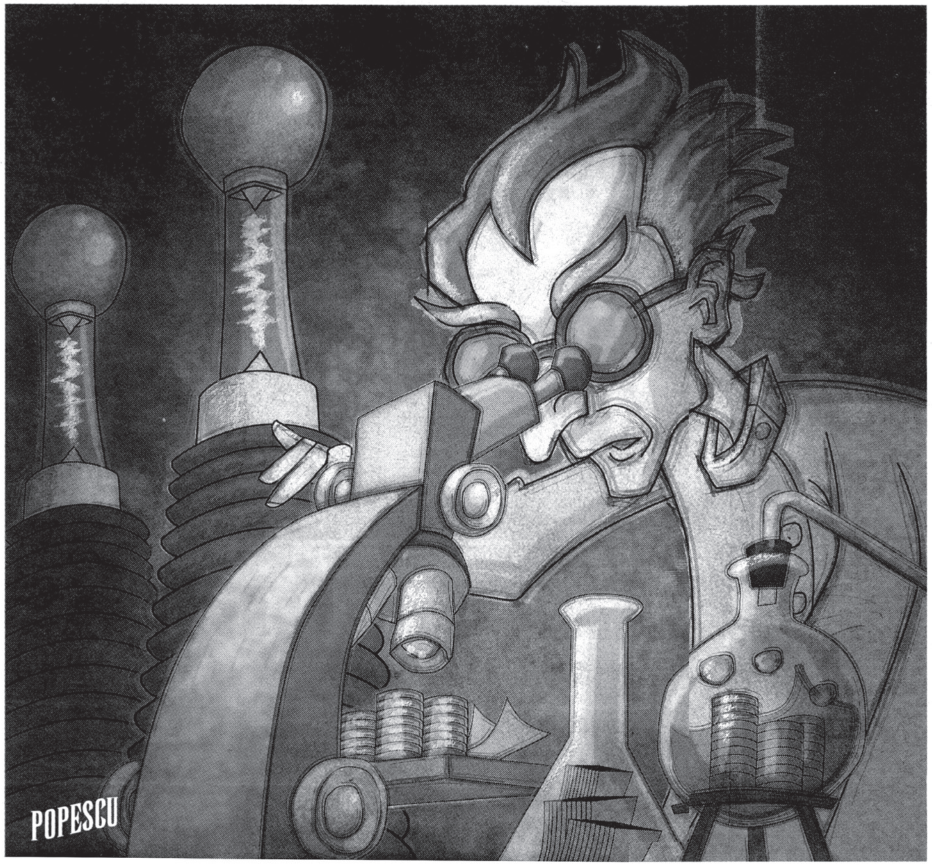
The more withdrawal and deposit options an account has, the less likely it is you're looking at a true savings account. Generally, the longer the term of the commitment, the higher the interest rate.

National Australia Bank's state general manager retail banking, Ann-Marie Chamberlain, said banks and other financial institutions generally offered two types of cash investments: high-interest savings accounts which allow on-call access but with better returns than standard transaction accounts, and term deposits. Online savings accounts are also coming into their own.

Comparison site Infochoice.com.au bears this out. BankWest is prepared to offer 3.55 per cent interest for $1000 plonked in a standard over-the-counter savings account. But if you can wait for your funds to transfer the next business day, online savings accounts with ING Direct and AMP will give you 8 per cent interest on that same $1000, and BankWest will give you 8.1 per cent interest.

This is a sign that the credit crisis is paying off for people with a little cash to spare. While investors may be happy with long-term returns of 8 per cent per annum on riskier shares, banks are now prepared to offer a higher return to get access to funds so they can lend them on to other businesses.

These higher rates are also, in many cases, beating term deposits as places to stash your cash.



BankWest is offering 8 per cent interest for a year-long term deposit and local banks Adelaide Bank and BankSA are topping out at 7 per cent – all less than the top online account.

But if you need this money in a hurry, beware: banks will impose a fee or cut your interest rate to offset their own costs in making up the short-term funding loss.

Australian Central managing director Peter Evers said institutions will consider your circumstances when deciding whether to levy the fee. "If you have to get money out a week early, we would look at what's happening, but if it is only a week or two in, you are probably going to get a material reduction in your rates," he said. "We are fairly flexible at supporting them when they need money in a crisis or toward the end of the term."

So why bother with a term deposit when a more accessible account may offer a better return? Certainty, said financial strategist Theo Marinis.

"Term deposits are more liquid, but you are locked in," he said. "When interest rates drop 1 per cent you are laughing, but not when they're cut."

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The jury may still be out on what is happening to interest rates. While the Reserve Bank is lowering official interest rates to promote economic activity, banks are prepared to offer higher interest to attract cash – an attractive proposition if you have cash on hand.

But term deposits can also be used strategically, Mr Marinis said.

"Don't lock up all your money in one deposit," he said.

"You might break it into four different lots with staggered maturity dates. It reduces your interest rate risk, and it keeps your liquidity flowing as you would only have a quarter of your money maturing (at any one time)."

A MATTER OF TRUSTS

Cash management trusts offer different access features and high rates of return – in exchange for a minimum balance. Your funds are played out on the short-term money market and so carry a higher risk level, but because they are not regulated by the bank regulator, they are more complex investments.

Investors should look to the investment rating of the account to determine just how risky they are. The Commonwealth Government, for example, carries a AAA credit rating and so pays lower interest rates because it is low risk. Macquarie's Cash Management Account carries a AAA-minus credit rating – still very safe, but the marginally higher risk should be rewarded with a higher interest payment.

BONDS, BILLS AND DEBENTURES

You can also invest your hard-earned cash directly with those people who want it: governments, banks and companies. Governments and companies raise funds by offering bonds or debentures with regular interest payments. The same risk-return issue applies: the higher the risk, the higher the return.

Credit rating agencies generally grade the risk of the instrument, which should be shown in a company's prospectus.

Sophisticated investors may want the best of both worlds and opt for bank bills. The bank issues bills with a promise to pay the face value at a specified future time, anywhere between one and six months. Investors buy them at a discount and so earn the difference between the purchase price and their face value.

Australian Central's Mr Ewers said the need to use brokers to negotiate and effect the transaction made traditional savings accounts and term deposits more attractive for the average cash investor.

But just to be on the safe, and perhaps conservative, side, my $2 is remaining in my hand. Until I find those trading cards, that is.