

# Observation Deck

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## Optimizing Your Global Cash Management

Renuka Kumar, *Portfolio Advisor*

Given today's increasingly global environment, our clients often face the challenge of managing operations across foreign subsidiaries – including effectively managing and optimizing cash flows and working capital. The need for greater efficiencies around managing cash and liquidity, together with the need to improve visibility and maintain control, are key concerns for clients with growing overseas operations. These needs, along with the desire to enhance returns, are what make an effective global cash management platform essential.

### Where to get started?

Your management of cash overseas can be viewed as an extension of your domestic cash management – both as short-term working capital and as longer-term managed assets. The overriding objectives of capital preservation, liquidity, and return should remain consistent. To develop an effective platform requires a thorough understanding of your current and projected cash profile by country and involves being familiar with the tools and investment options available to address your needs.

When it comes to understanding your cash requirements, ensure you are gathering sufficient information in regards to the amount and location of your international receivables and payables, and review transactions regularly to uncover trends. Examine your business model often to determine any future cash expenditures. These may include possible acquisitions, anticipated R&D, legal settlements, and cash committed for foreign exchange contracts. Given the recent volatility in FX markets, determining where your currency exposure lies and how to manage it is imperative from

a cash-control perspective. If you have this data readily available, you can easily forecast liquidity needs across global subsidiaries, freeing up excess cash balances for strategic management.

Once you determine your surplus cash, expand your investment policy to cover international investments, ensuring that your investment objectives carry over. This, combined with the company's liquidity forecasts, will set the stage for a global investment approach with the goal of maximizing returns within the parameters set forth in the policy. An ideal platform will give you the transparency and visibility into your investments across all currencies and will allow you to view the distinct portfolios in one central location. You should also expect to have the same tools that are available for your domestic portfolio (i.e. compliance, reporting, performance tracking)

### Available Options

*Multi-currency accounts:* This simple solution allows you to maintain bank deposit balances in foreign currencies at competitive interest rates. MCAs offer flexibility in managing foreign currency transactions which minimize exchange risk.

*Foreign exchange hedging:* Utilizing a proactive approach to managing your ongoing foreign exchange (FX) risk is a key component to protecting cash flows and locking-in profit margins. FX hedging strategies can offer variable solutions customized to fit individual requirements. The key to any successful hedging strategy is to focus on the right product mix – from spot and forward contracts, and currency swaps, to over-the-counter options.

*Overseas money market funds:* Money market funds provide safety and liquidity by investing in high-quality short-term investments and can be denominated in various currencies. International money funds should adhere to similar standards that are required of 2a-7 regulated funds.

*Foreign-denominated securities:* Incorporating foreign-denominated securities allows you to capture returns that may be above what can be earned in money funds or bank deposits. Investments in local currency debt should adhere to the approved instruments list for U.S. investments and to the same quality restrictions placed on U.S. debt securities.

Keeping in mind these guidelines and available options while developing your global cash platform will provide you with the benefits of having control and visibility into your cash, while potentially maximizing returns and allowing you to focus on the elements of your business.

### Markets

#### Treasury Rates

3-Month	0.14%
6-Month	0.19%
1-Year	0.27%
2-Year	0.55%
3-Year	0.82%
5-Year	1.60%
7-Year	2.30%
10-Year	2.91%

#### July Total Returns

ML 3-Month Treasury	0.02%
ML 6-Month Treasury	0.04%
ML 12-Month Treasury	0.10%
S&P 500	6.87%
Nasdaq	6.89%

Source: Bloomberg, as of 07/31/10

## Economic Vista

Minh Trang, CFA, *Portfolio Manager*

The economic data in July mostly pointed to a slowing recovery. This point was emphasized during Federal Reserve Chairman Ben Bernanke's testimony to Congress in which he commented that "the economic outlook remains unusually uncertain."

Softness in housing and labor continues to persist. In June, private payrolls increased by only 83,000, following the previous month of 33,000. Non-farm payrolls dropped by 125,000, due to less census workers. Housing starts declined 5 percent in June from the previous month to 549,000. This is a record low, following the expiration of the government tax credit for home buyers. Home sales remain near their trough with existing home sales at 5.37 million and new home sales at 330,000. Inventories are now hovering at 10 months supply.

Inflation remains benign. On a year-over-year basis, headline Producer Price Index and Consumer Price Index increased 2.8 percent and 1.1 percent, respectively. Excluding food and energy prices, PPI and CPI was up modestly at 1.1 percent and 0.9 percent, respectively. Given high unemployment and slowing growth, price pressure is expected to remain muted in the near term. Lastly, the preliminary GDP reading for second quarter 2010 came in at 2.4 percent, the fourth consecutive quarter of growth. This was a slight decline from the first quarter of 2.7 percent.

## Credit Vista

Melina Hadiwono, CFA, *Head of Credit Research*

In signing the Financial Reform Bill into law on July 21, President Obama emphasized that the law would end taxpayer-funded bailouts of banks and would end more aggressive consumer banking practices. This bill marks the first step in the establishment of a new regulatory regime for banks and other financial market participants. Most of the final rules are left to bank regulators to interpret and implement, which will take several quarters or even several years. In the meantime, while banks have already been evaluating their business lines, so far only a few have attempted to quantify the impact of the regulatory changes publicly.

The establishment of prudential standards, limitations on more risky activities of systematically important institutions, and introduction of a systematic risk regulator will most likely enhance the safety and soundness of U.S. financial markets. However, these could have unintended consequences of stifling domestic bank loan growth, which in turn could have spillover effects to the overall domestic economy. The new constraints on proprietary trading, derivatives and consumer banking, the major sources of growth of the banking

sector in the past 25 years, will put banks' profit models under pressure and they will likely search for new future growth prospects. Although it is too early to quantify the long-term impact on earnings, loss of revenue from certain lines of business is expected to hurt banks' financial performance. Nonetheless, we note that historically the banking industry has shown the ability to counter earnings reductions with product restructuring, innovation and repricing.

The ratings agencies have stated that they would like to review the details around all key aspects of the legislation, assess the implication to the credit quality of the banks and review the implementation of the rules before they take any rating actions. Over time, the rating agencies may take negative rating actions if they believe that the improvement in the large banks' fundamental financial performance is not sufficient to narrow the gap between the stand-alone credit profile and the higher ratings based on government support.

## Trading Vista

Hiroshi Ikemoto, *Money Market Trader*

With weaker-than-expected economic data and Federal Reserve Chairman Ben Bernanke's dovish testimony to Congress, the bond market remained bullish in July. The two-year Treasury note yield hovered in the low 0.60 percent range for the first half of the month. It then broke through to finish the month at 0.55 percent, a record low. The Treasury bill market was quiet, with yields from one week to five months around 0.15 percent and the one-year bill at 0.25 percent. Agency yields tightened to similar-maturing Treasuries with one-year bonds yielding plus 15 basis points to Treasuries, a 5 basis point tightening, to plus 12 in the two-year area.

The much-anticipated European Bank stress test revealed that seven out of the 91 involved banks failed. Much of this was expected. Rumors of these results, along with strong corporate earnings, caused strong demand for corporate bonds in the short end. The one-year forward LIBOR curve rallied 20 basis points to end the month at 0.47. With one-year corporate bonds priced against this curve, yields came down even as spreads against the curve remained the same. The spread between corporate bonds and Treasuries in the two-year maturity area tightened, with high-grade industrials plus 25 basis points and high-grade financials plus 45 to similar maturing Treasuries.

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