



Global Short-Term Investing

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Session Agenda

1. Domestic vs. international investing
2. First things first
3. Currency issues
4. Accounting issues
5. Portfolio tranches and capturing excess returns
6. Internal vs. external managers
7. Common mistakes
8. Policy issues
9. Concluding comments



Domestic vs. International Investments

- The differences between various international investment classes or categories are technically easy to master
- While the actual investments differ, the principles of sound domestic investment practices are identical for international investment practices
 - This presentation is about fishing in international waters, not about the fishes you will find there
 - And what you need for your boat and how to deal with the weather



First Things First – A Working Boat

A global cash management structure that efficiently moves funds to maximize the reduction of group debt and concentration of excess funds:

- Achieve efficient working capital management
- Improve cash flow forecasting
- Improve timeliness of balance information
- An efficient pipe network to move the funds
- Implement tax efficiencies
- Mitigate foreign exchange exposure
- Realize systems integration benefits



Managing the Weather — Currency

Swapping minor currency pockets of cash to major currencies **doesn't change** the all-in local currency nature of the return, but does **improve overall** returns with lower risk:

- Minimizes overall funds allocated for liquidity
- Avoids minor currency MM inefficiencies
- Avoids undue counterparty credit concentration
- Increases assets in a major currency, allowing more sophisticated investing at lower costs and with lower counterparty risk



Playing the Weather

One month roll swapping is generally inefficient:

- Settlement cash flow volatility is maximized
- If a core portion of swapped funds is expected to be permanent for 3-6-9-12 months, consider swapping out longer
 - Is a six month discount or premium on a p.a. basis historically attractive? Is it better than the 1 month?
- The overall objective is to play the local currency yield curve = forward yield curve + the major currency yield curve



Eliminating the Weather

Many US companies would like to have their international cash invested in USD as USD, not as foreign currencies swapped into USD (and back into LC later)

- Invest the excess non-dollar cash as capital in a new subsidiary
- Make the sub USD functional
- Invest the cash as USD with no FX risk
- It works, but it is not a tidy solution



Accounting Issues — 1

FAS 95, FAS 115, FAS 133, FAS 157 and FAS 159 are all important, but these accounting issues on **how returns are measured** must be mastered, made consistent and be SAS 70 Type II compliant:

- Trade date vs. settlement date accounting
- Tax lot vs. average cost
- Tax lot's FIFO, LIFO or specific lot selection
- Straight-line amortization vs. constant yield
- Amortization and accretion calculated on an 365/365 basis not on the securities' basis



Accounting Issues — 2

- An emerging trend is two independent valuations of portfolio
 - FAS 157 in 2008 will increase this trend
- There is more than just GAAP reporting
 - Internal compliance reporting
 - Regulatory compliance reporting
 - Tax compliance
 - Risk analytics



Cash Portfolio Tranches

Distinguish between working capital cash and true excess reserves by having different investment policies and benchmarks:

Tranche	Description	Investment Classes
1	1/7/14/28 day money to protect against unexpected liquidity needs	Overnights Call investments M/M funds
2	1-6 month money needed for seasonal or forecast cash needs	M/M funds Enhanced M/M funds Term deposits EuroCP
3	True excess cash reserves	Short-term bonds Deposits swapped Etc.



Enhanced Cash Funds

Enhanced cash products are positioned along the risk/return spectrum between money markets and total return short bond funds:

Risk Metric	Money Market	Enhanced Cash	Short Bonds
Portfolio Duration	90 days max	6 - 12 months	1.75 - 2.0 years
Credit Quality	AAA	AA	AA
Max maturity	13 months	2 - 3 years	3 - 5 years
Benchmark	3 month T-bill	1 year index	1 - 3 year index



Capturing Excess Returns — 1

- Term premium
 - Taking advantage of upward sloping yield curves by extending beyond 90 days
- Liquidity premium
 - Certain instruments do not have liquid secondary markets
 - Buy them with 6-18 months to go and hold to maturity
- Credit premium
 - Diversifying holdings to include a variety of investments that are of lower credit quality



Capturing Excess Returns — 2

- Diversify excess return risk by having multiple enhanced yield strategies
- Avoid short-term trading due to day-to-day shifts in market sentiment
- Define acceptable investments globally, rather than restrict regionally or have narrowly defined acceptable asset classes
- Chose managers with good proprietary quant models



Internal vs. External Management

- Internal management must have the same infrastructure as the external managers do
- Best to have an internal money manager managing her own in-house portfolio as well as to monitor the external managers
 - It takes a money manager to manage money managers
- The more conservative the investment policy, more likely that the outside managers will provide little value-added net of fees



Common Investment Mistakes — 1

Being too short because “you never know when the big acquisition might come”

- Large hidden cost of a bad forecasting process
- Major acquisitions always take months
- Investments can always be broken, with a 50/50 chance that it will cost
- Most investments can be collateralized if the need to have the funds quickly
- Serial acquirers will often not use outside money managers to avoid tipping them off



Common Investment Mistakes — 2

- Sacrificing yield for ultraconservative credit risk
- Not using interest rate derivatives
 - Short-term portfolio swapped long
 - Lock-in attractive resets with FRA's
- Not integrating the minor currency forward yield curve with the major currency yield curve
- Using brokers with no fiduciary responsibilities
- Not using custodians to hold your securities
- Repo'ing without receiving the security



Common Investment Mistakes — 3

- Stale investment guidelines
- Seeking too much yield without understanding the risks
- Not understanding the entire portfolio when broken up among several managers
- Not allowing uncollateralized investments of issuers with acceptable credit ratings
- Not allowing adequately rated collateralized investments of issuers with bad credit ratings
- Inadequate in-house investment infrastructure



Key Board Investment Policy Issues

- Need to keep the policy simple for non-financial business executives
- “Principle-based” policy rather than a detailed operating policy covering every eventuality
 - The detailed operating policy should be an internal document approved by the Financial Risk/Investment Committee
- Enhanced yield investment practices will more likely win approval if done by outside managers
- Assign responsibility for policy compliance
- Specify reporting requirements



Typical Investment Policy Components

- Purpose
- Authority
- Objectives
- Eligible investments
- Issuer credit quality
- Liquidity/maturity limits
- Position (CUSIP) limits
- Performance benchmarks
- Risk analytics
- Reporting responsibility
- Financial Risk/Investment Committee membership
- Use of vendors and investment advisors



Investment Policy Issues — 1

- Enjoin against the risks **associated** with a transaction rather than prohibit the transaction
 - No leverage
 - No purchase of volatility
- Require issuers to be rated, not their issues
- Restrict exposure to issuers, in both dollar and % amounts as of trade date, of **uncollateralized** securities
- Define how liquidity/maturity is calculated
- Mandatory custodial requirements



Investment Policy Issues — 2

- Procedures when a downgrade happens
- Portfolio benchmarks must be
 - Fair
 - Neutral
 - Reflect business constraints
- Internal controls
- Investment/Financial Risk Committees
 - Evaluate results
 - Ensure compliance with policy
 - Ensure policy is relevant and updated



Concluding Comments

- People are paramount because people can render any investment process — or any treasury process — ineffective
- There is no substitute for hiring honest individuals with judgment and market experience
- The challenge is to develop a culture which attracts and motivates these kinds of people



Useful Resources

- Bank of New York
- Clearwater Analytics
- iMoneyNet's IMMFA Money Fund Report
- gtnews.com
- DecisionAnalytics



About Greenwich Treasury — 1

Since 1992, Greenwich Treasury Advisors has been delivering integrated treasury solutions for over 300 global businesses:

- Risk
 - FX/IR/commodity risk assessment and policies
 - FAS 133/IAS 39 hedging and documentation
 - Performance measurement
 - Best practices
- Cash
 - Global liquidity management
 - Cross-border cash consolidation
 - Bank reviews and RFP development



About Greenwich Treasury — 2

- Structures
 - Diagnostic treasury reviews
 - Implementing spin-offs and merger treasuries
 - In-house banking and outsourcing
- Technology
 - Treasury system RFP's, review and selection
 - Treasury intranet and web application design
- For more info, visit www.greenwichtreasury.com
 - Free articles on risk management, FAS 133, treasury systems and treasury maxims at </articles.cfm>



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 - *The Group of 31 Report: Core Principles for Managing MNC FX Risk* (AFP, 1999)
 - *A Risk Metric Approach to Hedging* (GTA, 2002)
 - FAS 133 chapter of *The Handbook of International Finance & Accounting* (John Wiley, 2004)
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