Rising Rates Require Treasurers to Revisit Investment Strategies

Rising interest rates are driving changes in short-term investment management.

Before the Federal Reserve started raising short-term interest rates in the summer of 2004, rates were so low that many companies simply left excess cash in Demand Deposit Accounts (DDAs). Some even abandoned automated sweep accounts because the higher rate of return wasn’t enough to justify sweep fees.

Since last summer, however, the Fed has embarked upon a series of hikes in the fed funds rate, which after the Fed’s May 3 meeting stands at 3%, triple the June 2004 rate. What’s more, because the Fed is expected to continue on this course, the short end of the yield curve has developed a slope, creating opportunities for increased returns.

Automate your cash management
With rates rising, many companies have been returning to sweep accounts, says Mary Abbott, Product Manager for sweep and zero balance accounts at U.S. Bank. “Sweeps offer above market rates while still providing access to funds,” she notes.

Sweep accounts provide an automated, no-hassle form of investing for busy treasury managers. At the end of each business day, a sweep account automatically determines the total deposit balance in your commercial checking account that is available to invest. Excess funds above your target balance are moved into an overnight investment, and the principal plus interest earned are returned to the checking account the following morning.

U.S. Bank offers a wide variety of sweep investments, including commercial paper, eurodollars, repurchase agreements and money market mutual funds*. “Most organizations will be able to find a U.S. Bank sweep product that fits within their investment policy,” Ms. Abbott notes.

Companies with multiple DDA accounts can pursue better short-term investment performance by establishing a zero balance account (ZBA) structure. A ZBA structure allows you to automatically consolidate excess funds from various sub-accounts into a main account at the end of the day. Funds from the main account can then be swept into overnight investments.

Loan sweeps
Reducing debt and interest expense is another alternative for putting excess balances to work.
Customers may use U.S. Bank’s loan sweep service to move excess funds automatically from a checking account to pay down an outstanding balance on a line of credit.

A loan sweep can be used in conjunction with an investment sweep account, in which case the service will pay down outstanding credit balances before investing any excess funds. If no outstanding credit balance exists, all excess funds will be invested.

**Ladders and barbells**
Companies have begun to take a more active approach to short-term investments, says Ken Nelson, Senior Vice President in the Corporate Treasury Division at U.S. Bank. “Treasury managers are starting to ask: Am I in the best product? Should I be earning interest on my funds? Should I be extending out on the yield curve?”

Most businesses are keeping their investments relatively short-term, anticipating higher rates, he says. However, some are opting for “laddering” or “barbell” strategies that combine short-maturity investments with some longer-maturity investments to take advantage of higher rates out on the yield curve.

Talk to your U.S. Bank Relationship Manager about the impact of rising interest rates on your treasury management practices. Your Relationship Manager can put you in touch with the experts in Treasury Management and our Money Center fixed-income investments group who can provide the products you need, including U.S. Bank-issued products backed by our AA credit rating.

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*These investments are not insured by the FDIC.