

Are money market funds a sanctuary amidst turmoil?

Increased risk aversion in markets due to the credit market turmoil and the subsequent financial crisis has prompted many investors to gravitate towards lower risk asset classes such as cash and cash equivalents. This has resulted in large inflows over the last few months into South African money market funds.

In the current global economic environment many investors have for the first time started scrutinizing the security of their cash investments, whereas in the past cash was mostly accepted as a “risk free” investment with capital preservation virtually guaranteed. South African investors can take comfort from the fact that whilst there is significant volatility in global markets at present, the SA Banks have very limited direct exposure to the major asset classes causing the international uncertainty and crisis of confidence. Our banks remain well capitalised, are all profitable and have limited funding exposures to international markets. As a sign of confidence in the domestic system, the interbank and corporate funding markets have continued to function appropriately despite the international uncertainty.

Further, the SA Reserve Bank has not had to introduce additional liquidity into our banking system, as has occurred in many of the developed markets offshore. Our banking system is highly concentrated in the five biggest South African banks, whereas the US system is spread amongst 8,500 banks. The implication of this is that our banks are – relative to the size of our population and economy – in a stronger position.

South African banks are regulated by the National Credit Act which enforces stringent lending practices in the local market. Partly because of exceedingly low interest rates in the US and partly because of complacency and mismanagement, US lending practices declined alarmingly over the past few years, especially with regard to the sub-prime issue (lending to borrowers who had little or no credit rating). Although there is uncertainty

because of the American problem, there is no unusual stress in our banking system and we have a low reliance on offshore funding.

Money market funds, as regulated by the Collective Investment Schemes Act, 2002, provide “built-in diversification” through investing in multiple counterparties. The investor is therefore sheltered from inappropriately high concentration risk by not having all of his/ her eggs in one basket. Further, as a result of local exchange controls many of the South African Money Market Funds have been precluded from holding some of the instruments that have been at the centre of the credit crisis internationally. Many investors have therefore selected Money Market Funds to house a portion of their cash in volatile markets.

The Standard Bank Money Market Fund is a well diversified portfolio of money market instruments (as defined in the Collective Investment Schemes Control Act, 2002). The primary performance objective of the portfolio is to obtain as high a level of current income as is consistent with capital preservation and liquidity. Capital gains will be of an incidental nature. This portfolio may not have any direct and/or indirect foreign exposure. The maximum duration of any one instrument included in the portfolio may not exceed 12 months and the weighted average duration of all instruments included in the portfolio may not exceed 90 days. (Refer to the attached fund fact sheet for further information on the Standard Bank Money Market Fund).

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