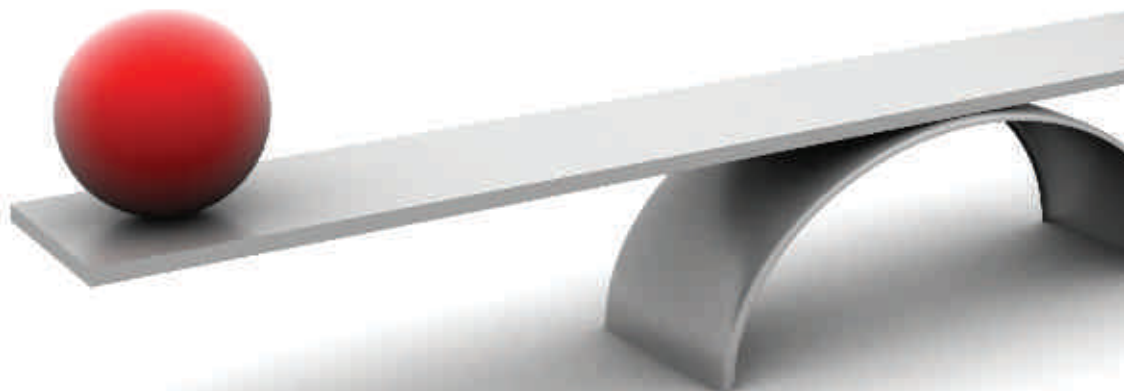


INVESTING CORPORATE CASH: IT'S BACK TO BASICS



Credit is tight. Capital markets are turbulent. Monetary easing has pushed interest rates over a cliff. It's time to get back to basics when it comes to investing corporate cash. **Diversified portfolios** and **sound investment analysis**—appropriate in good times and bad—provide the key to **optimizing security, liquidity and yield.**



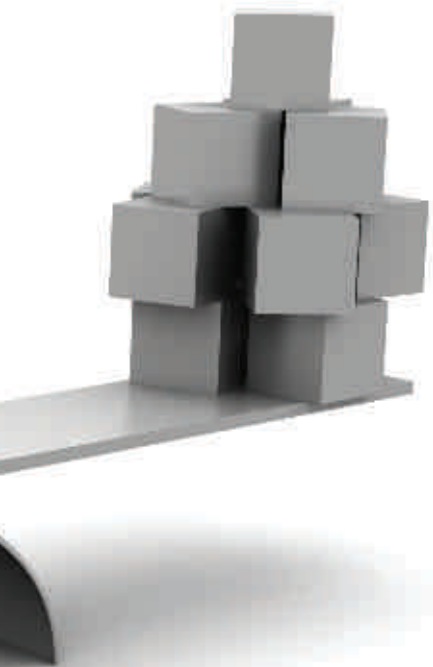
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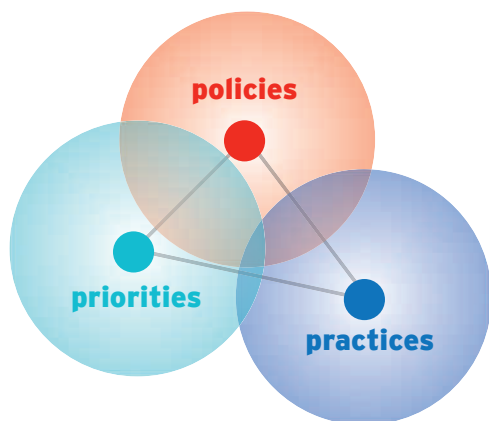
MARKET DRIVERS

Over the past year, corporate investors have faced an unsettling combination of elevated risk and reduced prospective returns—compounded by uncertainties regarding how securities markets will operate going forward. CFOs and treasurers shifted priorities in a natural reaction to events such as the collapse of Lehman Brothers and downgrades in bank and sovereign ratings. In response, companies have been investing for the short-term, with acute awareness of the need to protect principal and maintain liquidity. But, the climate is changing as markets have stabilized.



BALANCING SAFETY, LIQUIDITY AND YIELD

The environment calls for getting “back to basics” and using prudent portfolio management practices to set the optimal balance between safety, liquidity and yield. The tried and true approach involves thorough analysis of investment priorities, policies and practices.



SETTING INVESTMENT PRIORITIES

“Safe” is a relative term. Any investment entails a trade-off between risk, preservation of capital, liquidity, and yield. In establishing investment priorities, treasurers must assess the cash generation and usage needs of their businesses, cash on hand, and the treasury resources and infrastructure in place.

Rather than treat all cash as fungible, companies are segregating cash into categories based on specific functions, time horizons, and liquidity requirements. Assessing cash in terms of frictional, working capital reserves, and strategic or special purpose reserves allows for clear setting of expectations for preservation of capital, liquidity, and return for each category. After all, “safe” instruments may not provide protection against market risk, should there be unexpected liquidity needs. Investment instruments can then be aligned with each category of cash to create a blended portfolio targeting appropriate returns.

The next step is to establish risk appetites and yield expectations. This includes answering key questions such as: How much and what level of risk is acceptable? Can any capital loss can be tolerated? For what proportion of the portfolio is daily liquidity necessary? What are yield expectations? Is performance measured against specific benchmarks or targets?

ALIGNING INVESTMENT POLICIES

It is prudent to review investment policies on a semi-annual basis, more frequently when there are significant changes in the market or in corporate circumstances. Recent market events have driven many boards and CFOs to consider worst-case scenarios. However, overly restrictive policies create inflexibilities and can limit opportunities as market conditions stabilize. Rather than set highly constraining policies, many companies are using strong oversight of investment practices and processes to ensure alignment with objectives.

Another factor for consideration is the level of involvement on the part of corporate treasurers. With the economic downturn, a greater proportion of corporate assets are being held in cash, however many treasurers are internally managing funds that might previously have been invested by external advisors. Again, good oversight helps ensure alignment with objectives.

ESTABLISHING ROBUST PRACTICES

Once priorities and policies are clarified, a solid framework is needed for investment practices and processes. Controls and visibility are critical when it comes to investing corporate



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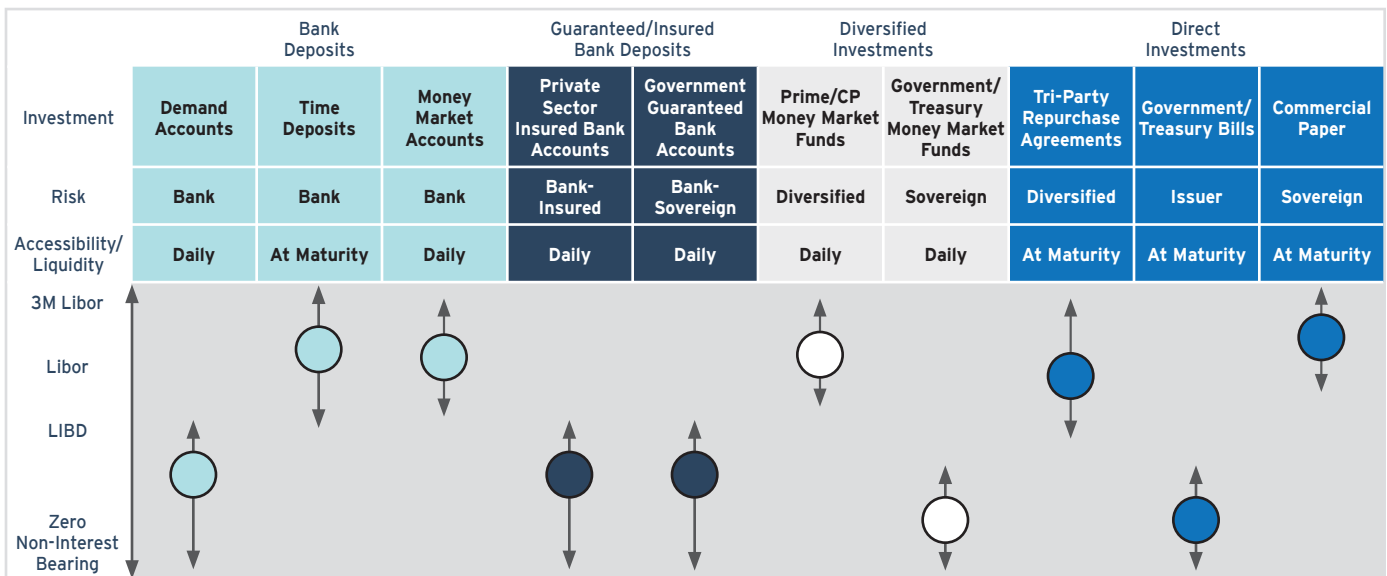
Citi's liquidity and investment services include Citibank® Online Investments, a secure global portal that gives you access to a variety of short-term investments through our award-winning, web-based platforms, CitiDirect® Online Banking or TreasuryVision®. Citibank Online Investments allows you to manage your short-term investment portfolio with the maximum amount of convenience and efficiency.

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cash. Centralizing and rationalizing internal cash processes and external banking structures greatly facilitates good investment practice. By integrating operating cash management, liquidity management structures, and investment processes, companies can obtain timely information on cash positions and make sound investment decisions. This is critical for monitoring portfolio risks, compliance with policy, and investment performance.

In addition to this, companies are no longer willing to rely wholly on rating agencies to assess investment risks. They are seeking to directly understand risks and considerations. The expanded due diligence includes asking questions, demanding information, and seeking interaction with investment managers, intermediaries and financial counterparties. For example, with money market funds, investors are analyzing fund types, how they are structured, their underlying investments, and their investment strategies. The quest for information doesn't stop there—they also are taking a closer look at funds' portfolio managers and their track records.

Investment Options: Risk/Return Spectrum



The technology infrastructure is a critical component in all of this—for automation and control over processes and to free time to focus on investment analysis and decision-making. Web-based platforms, such as the Citibank® Online Investments portal, have become key tools for centralizing investment processes, from dealing to settlement, as well as for timely access to information including portfolio holdings, rates, and research. For corporations that have sizeable fixed income portfolios, Citi also offers its Treasury Analytics platform, which consolidates risk, compliance, accounting, and performance analytics across all investments.

INVESTMENT OPTIONS

For several years, a variety of short-term investments options were considered to be relatively homogenous in terms of offering low risk with high liquidity. This has not proven to be true and changes in the market have fostered a return to long-standing prudent practices. The array of generally used short-term investments falls into a few groups.

Bank Deposits: Bank deposit choices range from lower-yielding, highly liquid interest-bearing demand accounts (including overnight sweeps in some jurisdictions, such as the US); to money market accounts, which offer higher yields in return for certain balance and liquidity requirements; to fixed-term time deposits. Generally, account-based bank deposits offer the highest liquidity and reflect interest rate changes instantly. With good cash forecasting practices, companies can use time deposits to go out on the yield curve. In a number of jurisdictions, sovereign or other bank deposit guarantees are available, such as from the FDIC in the US, but should be noted that these often come with specific requirements, e.g. with regard to interest rates, residency, currency availability, etc.

Money Market Funds: Investment flows into money market funds have continued to grow, with differentiation by investors across funds. After the surge of holdings into Treasury and government funds in the autumn of 2008, there has recently been some flow back to prime/commercial paper funds, as investors look for additional yield while maintaining controls on risk and liquidity.

Treasury Bills: Sovereign debt, especially U.S. Treasury bills, has historically been the primary instrument for “flight-to-quality” investors. Risk aversion temporarily pushed yields on three-month US T-bills below zero in 2008.

Commercial Paper: Following the collapse of Lehman Brothers, volumes in the commercial paper market plummeted. Corporate investors dramatically reduced direct holdings of commercial paper and asset-backed commercial paper. Despite the yield differentials currently available, many corporate investors have yet to re-enter the market in a meaningful way.

Repurchase Agreements: A repurchase agreement (repo) is a contract between two parties in which one sells a security to the other with the commitment to buy the security back at a specified price, at a designated future date. The securities, or collateral, for repurchase agreements are typically U.S. Treasuries or Government agencies. In a tri-party repo a custodian bank or clearing house acts as the intermediary between the two parties, with responsibility for administration of the transaction, including collateral allocation or substitution and marking to market. Tri-party repos are seen as a means of reducing counterparty risk, since an agent holds the collateral.

CONCLUSION

Conditions in financial markets and the economy have intensified the demands on treasurers. Making the right investment decisions is a balancing act. It requires building a sound investment strategy based on clear priorities and appropriate policies. It also requires implementation of processes and infrastructure to ensure maximum visibility and control over cash and investments. Finally, investment portfolios must be monitored and evaluated on an ongoing basis to ensure that they are aligned with business strategy and risk appetites—and to make adjustments in investment policies and practices, as necessary, based on changing market conditions. ■