BEYOND BANK DEPOSITS

Investec Europe's **Gabriel Ramsey** explains why, in a low-interest rate world, there is no such thing as a free lunch.

When we look back at the past year, since the start of the COVID-19 pandemic, one of the most striking effects of the resulting economic crisis has been investors' retrenchment back to deposits.

According to data published by the Central Bank of Ireland, private deposits increased by a record €14.2 billion in 2020. The most noteworthy aspect of this revelation was the additional €950 million increase in December, a month when savings traditionally fall as high-street sales soar.

On the flip side, we have experienced a significant contraction in consumer borrowing, which declined by 4.5% over the same period.

Household deposits

Meanwhile, as savers continue to squirrel away their excess funds, the European Central Bank (ECB) dissuades EU financial institutions from placing funds with them. For the economy to reboot, for growth to take hold and green shoots of inflation to begin to protrude, the ECB is pulling all its available levers to encourage more borrowing and spending as opposed to saving and hoarding.

Herein lies the conundrum. Savers are preparing themselves for the unpalatable scenario of paying their bank for holding their deposits. Banks have passed on the ECB's negative rates to larger corporate and institutional-type depositors for some time. However, retail depositors have generally been spared the pain until now – but the mood music is changing with banks applying negative rates to pension accounts and retail clients with large deposits.

It appears inevitable that all personal deposits will be next in line, with some banks changing their terms and conditions to allow for this eventuality.

Where to now for savers?

While we must expect the hoarding of cash to inevitably dissipate as we continue to see downward pressure on interest rates and sentiment continues to improve, the problem remains. With interest rates and bond yields remaining below inflation for the foreseeable future, what can investors and depositors do to preserve their capital while generating returns?

Investec has provided award-winning investment solutions to Irish clients for over 15 years. During periods of low interest rate returns, we provide our clients with alternatives to deposits and create individual bespoke products tailored to each client's needs. We provide transparent and straightforward solutions linked to varying asset classes and utilise high-calibre counterparties to optimise return while delivering high levels of capital protection. Most clients will be familiar with equities or interest rates and prefer a product where performance is linked to one of these underlying asset classes.

Investec's 'Kick-Out Plan' is a good example of an equity-linked product (EuroStoxx 50) that does not require exponential equity market growth to perform well. In fact, the performance of this product over the past five years, when European equities have remained broadly flat, demonstrates this:

- Over 1,500 investors.
- An average term to maturity of 1.5 years.
- An average return of 6.8%.
- No capital losses to date.*

** This type of product does carry risks. In the above product example, clients' capital is protected provided the EuroStoxx 50 does not fall 40%. Investors are aware that they may be sacrificing full capital protection in order to achieve some return in a low-growth equity market. In this type of product, the level of capital protection and the potential returns are directly correlated (i.e. if a client's main goal is capital preservation, they may be prepared to sacrifice yield in order to achieve this).*

Meanwhile, some clients are unwilling to risk their funds and require an alternative to deposit, either for their personal or pension funds or company funds. In this scenario, Investec can provide fixed income notes with a medium-term maturity that offer a small fixed return over the period (e.g. 0.10% per annum) and the return of capital on maturity. While the returns are modest in this structure, they are popular with clients who have no immediate plans for these funds and face the prospect of negative interest charges depleting their capital.

These investment structures are typically medium-term notes (MTN), which are debt securities issued by banks as an alternative funding source. The principal attraction to investors of notes over deposits is the ability to customise the various components into one instrument and manipulate the capital protection levels to suit.

The credit risk of the issuer is a key consideration with this type of product, and Investec works closely with highly rated investment grade financial institutions to offer peace of mind to clients. These banks are generally very familiar international names but are often not accessible to a retail client directly and, therefore, provide diversification to an investor's portfolio. It is important to note that although most notes are senior unsecured issuances, these products are not covered by deposit compensation schemes.

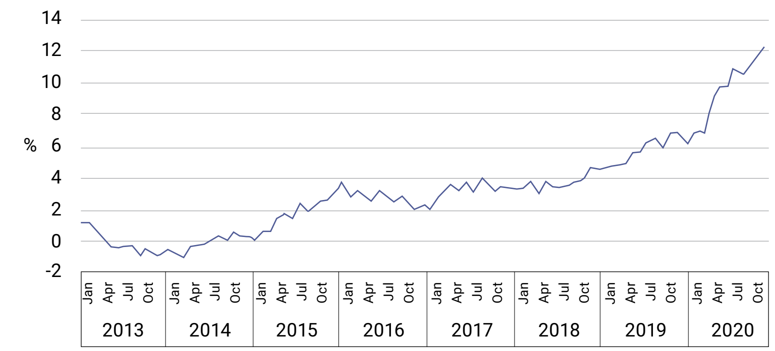
Advice

Investec's investment solutions are classified as MiFID (Markets in Financial Instruments Directive) products and deemed 'complex'. It is therefore vital that clients receive professional financial advice.

Investec works closely with advisors to create strong value propositions. However, the suitability and appropriateness of such investments are critical and individual to each investor.

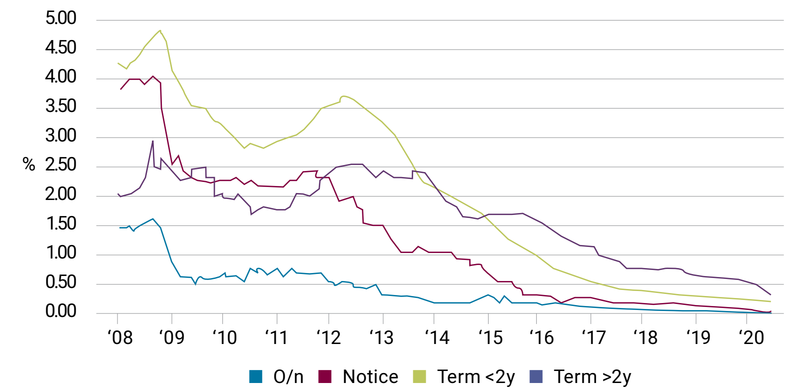
In the current climate, whether you require a solution for your funds or have clients with lump sums on deposit seeking your advice, it is important to understand and manage the risk. If you would like more information regarding the bespoke solutions available at Investec Treasury products, we would be delighted to speak to you.

FIGURE 1: Household deposits



Source: Central Bank of Ireland

FIGURE 2: Retail deposit interest rates



Source: Central Bank of Ireland

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