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Don't miss out on hefty returns on your cash

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Investors contemplating locking in a fixed term deposit at near 8 per cent shouldn't wait too long.

The country’s major banks are currently offering very attractive rates on fixed-term deposits. But pause for too long and you could miss out on the best conditions for fixed-term deposits in yonks.

Boring they might be, it was the predictability of a fixed timetable for the payment of interest and the repayment of principal that attracted investors to fixed-term deposits during the GFC. Investors who were quick enough last December could have snafoo’d 8 percent on a Westpac five-year term deposit, and The (unrated) Bank of Cyprus Australia is still offering a similar rate of 7.90 per cent over the same term.

Abnormally high fixed-term deposits are a function of banks relying for more of their funding on retail deposits, which tend to be more sticky and not subject to the nuances of cheaper wholesale markets. Changes to banking regulations are likely to require banks to hold a larger amount of their funding as deposits in the future.

As a result, the desire for banks to get a greater slice of their funding from ‘mum & dad’ investors has created a fiercely fought battle for deposits. The by-product of this furore is that major banks are currently paying out at levels typically the domain of credit unions.

According to Shane Oliver chief economist and head of investment at AMP, investors thinking about locking in fixed-term deposits anywhere near 8 per cent shouldn’t hang around for too long. Within six months he expects an easing of bank pressure for retail deposits to see fixed-term deposit rates start falling back to normal levels - if they haven’t started to do so already.

The Reserve Bank’s (RBA) latest interest rate hike to 4.25 per cent has created some upward pressure on fixed-term deposits, and major banks raised their online savings accounts by a corresponding 25 basis points within hours of the announcement. Nevertheless, Oliver expects rates to come back down as money markets continue to improve. “The impact will dwindle the longer-dated the fixed-term is - with five to 10 year term deposits unlikely to see any upside from the RBA announcement,” says Oliver.

For older retirees, or conservative investors unperturbed by the prospect of locking up cash on term deposit, he says current rates of between 7 and 8 per cent look extremely attractive. Included among the best rates currently on offer for five years are Bank of Cyprus Australia at 7.9 percent and Bank of Queensland on 7.6 per cent – with the best of the majors: Westpac and St George offering 7.05 per cent and 7.25 percent respectively.

Adding to the attractiveness of these rates, adds Oliver, is their current risk-free status - courtesy of the Government Guarantee (on deposits of more than $1 million in banks, credit unions and building societies) which expires in October 2011. Nevertheless, he says shares should remain a better proposition on a longer-term horizon.

“Assuming there’s reasonable growth and franking credits are also factored in, shares should deliver 11 percent over five years, and even more over a longer outlook – but remember, with shares comes volatility.”

Admittedly, the sweet spot within the fixed-interest curve depends a lot on an investor’s appetite for other asset classes, notably equities. But Oliver expects four to 12 months to remain popular time frames with investors wanting the flexibility to respond to other market opportunities at relatively short notice. Assuming inflation remains under the mandated 3 percent over the next few years, fixed-term deposit of around 8 percent offers a real rate of return of 5 per cent plus with low-risk.

This rate of return looks attractive in anybody’s language, yet Colin Campbell private client adviser with Wilson HTM urges investors to compare ‘apples-with-apples’ to ensure they invest in what they think they’re investing in. “Look for investments offering interest payments quarterly as opposed to ‘on maturity’, and ensure they’re Government Guaranteed,” advises Campbell. “It’s also a good idea to steer away from perpetual securities where the decision to make distributions is more discretionary.”

So if commentators are right and we are on track for another two RBA rate hikes this year – taking it to 4.75 percent - how can investors make the most of the best conditions for fixed-term deposits in years? Most fixed interest experts suspect that much of the upside from another two rate hikes is already factored into current rates.

For those worried about rates continuing to rise, Steven Wright director of fixed-interest with RBS Morgans suggests rolling deposits at shorter intervals. Instead of simply shifting deposit terms, Wright also suggests shopping around for the best rates across two or more banks. He says investors also need to coincide maturity dates with when they need the money. Wright also reminds investors that interest paid out in July won't be taxed until the following financial year.

Wright has noticed greater client interest in two to three year fixed-terms where the best rates range between 6.88 per cent and 7.4 per cent respectively. While Bank of Cyprus Australia and Rural Bank rates for three years are 7.4 per cent and 7.12 per cent respectively, ANZ - the best of the majors - is currently offering 7 percent over the same term.

But he says today more investors regard a rate of 6 per cent plus – that some banks and credit unions are now offering on 180 days - as the most attractive trade-off between the rate and the term. While the Police/Nurses Credit Union is offering 6.34 per cent on 180 days, Rural Bank – the best of the banks over this fixed-term - is offering 6.05 per cent.

Wright urges those with surplus balances in on-call funds to consider locking in higher interest rates on term deposits while they remain abnormally high. On shorter fixed terms, some rates look equally attractive with 90 day fixed-term deposits offered by credit unions – up to 5.99 per cent – comparing favourably with around 4.4 per cent for a 90 day bank bill.

For investors expecting higher levels of return there are always hybrids securities. But as they comprise a mix of debt and equity, Andrew Murray director with Curve Securities warns investors that these investments, like corporate bonds – which remain thin on the ground - come with greater degrees of risk.

Investors experienced a rough ride with hybrids last year with even the more stable bank variety getting caught up in huge amounts of volatility. As a case in point, the Westpac Trusts (WCTPA) traded as low as $60.52 before rebounding to as high as $94.40, while Multiplex Sites (MXUPA) rallied from a low of $17.50 to over $76. Despite these sorts of stellar returns, Murray warns retail investors against buying over-engineered hybrid fixed-interest products they neither understand nor have the risk appetite for. "Investors have to weigh-up 'risk-free' term deposits that have been trading up to a whopping 200 bps (basis points) (or 2 per cent) over wholesale market rates, against added risks associated with fairly illiquid high-risk hybrids," says Murray.

He expects the gap between fixed-term deposits and wholesale market rates to remain abnormally high until securities markets return to normal levels. "We expect it to have narrowed to around 100 bps by year's end," says Murray. "Even if the cash rate ever got to 6.5 per cent, it would still be worth the punt of locking in five years at around 7.5 per cent."

Fixed-term deposits – Snapshot of rates

Issuer	30 Days	60 Days	90 Days	180 Days	1 Year	2 Years	3 Years	4 Years
Police/Nurses Credit Union	5.8%	5.89%	5.99%	6.24%	6.51%			
NSW Teachers Credit Union	5.65%	5.74%	5.84%	6.1%	6.36%			
Railways Credit Union	5.65%	5.74%	5.84%	6.1%				
Community CPS Australia	5.5%	5.6%	5.8%	5.95%				
Savings & Loans Credit Union	5.5%	5.8%	5.85%	6.1%	6.45%	6.95%		
Bank of Cyprus Australia				5.9%	6.15%	6.4%	7.4%	7.4%
Rural Bank				6.05%	6.42%	6.88%	7.12%	7.36%
Adelaide Bank				6%	6.05%	6.15%	6.65%	6.9%
Bank of Queensland				6%	6.35%	6.85%	7.1%	7.4%
CBA					6%	6%	6.5%	6.5%
NAB					6%	6%	6.5%	5%
Westpac					6%	6%	6.5%	6.5%
ANZ					6%	6%	7%	6%
St George					6%	6%	6.5%	6.5%

Source: FIIG 7 April 2010

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