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Keep it Liquid

A need for cash means business owners often stash too much capital in low-yield investments. Stop losing returns. Here's how

WRITTEN BY STUART FOXMAN

Cash needs can pop up quickly, so business owners understandably want to keep a portion of their funds liquid. This leads them to low-risk savings, GICs, or money market funds, with the tradeoff of low yields. Concentrating their personal investments in these low-risk products can train entrepreneurs to accept less-than-ideal returns.

Sometimes, there's a great risk in not taking a risk. Just ask one owner-manager from Southern Ontario, who was looking to buy American property. With that goal, he moved cash into U.S. treasury bills. He was making just 2% but didn't care, says Ian Niven, vice-president of the Private Wealth Group at BMO Harris Private Banking: "He thought he was being conservative, instead of taking a chance with equities."

Due to currency fluctuations, the client actually lost 25% of his capital in Canadian dollar terms. The perceived low-risk (and low-yield) T-bill, says Niven, "ended up being more volatile than the equity market." What vehicles combine higher yields and a measure of liquidity? Wealth managers suggest their best alternative strategies.

▶ Being in cash offers false comfort, says Ryan Bushell, portfolio manager at Leon Frazer & Associates, Toronto. With the bite of inflation, you're almost guaranteeing a loss. His firm targets at least 3% growth above inflation over the long term. One option is large-cap dividends, but Bushell also touts covered-call writing—you buy a stock and sell the right to someone else to buy it at a particular price for a set period. "During that time, you get dividends, plus whatever someone pays you for the option," he says. "It works in this type of market, where stocks aren't going up dramatically."

▶ Gary Brent, CEO of Highview Financial Group in Oakville, Ont., describes one client in technology with a successful operating company. He had treasury assets in the millions that were earning "nothing," so Brent shifted a large percentage into an investment holding company. "There's a corporate bond exposure, overlaid with dividend-oriented Canadian and global equities, which offers about a 5% yield. Everything is liquid except some income-oriented commercial real estate, which is about 15% of the portfolio and gets around a 7% yield. It's diversified, there's long-term growth, and it's very transparent." After about $2 million was moved from low-interest rate vehicles, the enhanced yields have netted the client an additional $50,000 a year.

▶ For "low-risk money," Gray Rumball, president of Calgary's Vantage Point Investment Management, advocates buying high-quality, short-term corporate bonds. "There are lots of innovations in laddered corporate bond portfolios, all investment grade, staggered from one-to-five years so the interest rate risk is low. And it's reasonably liquid," he says.

▶ If you're keeping a buffer in a short-term money market vehicle or government bonds, the most natural substitute to earn a greater yield is increasing your exposure to corporate bonds, says Paul Taylor, chief investment officer at BMO Harris Private Banking in Toronto. But further out on the risk spectrum are vehicles like hedge funds that produce a regular and predictable rate of return.

▶ With typical money market funds yielding below 1%, Dan Goodman, CEO of GFI Investment Counsel in Toronto, likes the returns of safe preferred shares, which average 4.5%. REITs can bring an even higher yield, 6% to 8%: "They pay monthly distributions, are phenomenal long-term investments, and very liquid. But you're subject to interest-rate exposure."

As Goodman suggests, within an overall higher-yield strategy, there's nothing wrong with keeping some assets highly liquid. The question is how much? Business owners typically overestimate their cash needs. About 5% of total liquid assets or up to a year's worth of net after-tax income should be accessible in the short term. More than that will dilute your overall rate of return. ●

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