

## The High Cost of Liquidity

In over 25 years as a wealth manager, I have encountered many people who I refer to as liquidity hoarders. For whatever reason they want to make sure that all their assets are 100% liquid. Obviously, it is important to have sufficient liquidity to meet your short-term living expenses and have sufficient emergency funds. However, maintaining excess liquidity can be very expensive.

Unless you are planning to cash out your entire net worth this week to spend it all, excess liquidity is unnecessary. When you purchase a stock or an ETF, those are liquid investments. You can usually convert those to cash at a moment's notice, but that liquidity isn't free.

When a private company goes public, the company will often trade at a higher price relative to its earnings than when it was private. Investors are essentially paying a liquidity premium. Currently if you invest in the S&P 500 you are paying 26.89 times earnings. \* If you invest in a private equity fund which may take a month or longer to liquidate you are paying closer to 10 times earnings.

When an investor pays a lower multiple, they are paying less for a share of a company's profits. This may be one of the reasons why private equity has outperformed public markets by a substantial margin. Although public stocks are always liquid, in times of financial crisis, there is usually an imbalance of sellers which can cause prices to drop significantly.

History has shown that the worst time to sell is during a panic. Therefore, investors are paying a premium for the right to sell at the worst possible time. On the fixed income side, you can purchase a 10 - year treasury bond which yields 4% interest, and you can sell that at any time. However, if you are willing to accept less liquidity, you can earn 6% guaranteed on a 10-year fixed annuity. That is 50% more return than a liquid bond. By giving up some unneeded liquidity you can often increase returns.

\* [S&P 500 PE Ratio - Multpl](#)

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