

Mitochondria Learns to Invest #10
by Klarise Yahya, Apartment Loan Broker

Continued from last month ...

“Do you recall when we had our first little talk about investments? We established that investments provide a stream of income”, Mrs. Langerhorn began. “And I think we actually said that the only thing investors do is accumulate streams of income.”

We’ve all seen the tragedy that results when folks owning several apartment buildings – but with absolutely no cash under the mattress – get hit with an unexpected emergency.

Mrs. Langerhorn didn’t stop there, because the explanation, although accurate, was incomplete. She wanted to demonstrate the choices available when one shops for a stream of income. “When I was growing up,” she said, “my father used to take the family car to a mechanic in the village who had an old, peeling sign on his garage wall. Translated into English, it read:

Good – Fast – Cheap
(Pick Two)

“The mechanic was stating that he could provide *good* service *cheaply*, but it won’t be *fast*. Or, he could provide *good* service *fast* but it won’t be *cheap*. Finally, he could provide *fast* service *cheaply*, but it won’t be *good*. I used to think it was a very amusing sign, until many years later when began accumulating streams of income. Then I realized that there should be a similar sign on every investor’s wall:

01: Liquidity + Safety
02: Liquidity + Growth
03: Illiquidity + Safety & Growth
(Pick One)

“At the macro level, an investor has only three options. She can purchase a stream of income that is *liquid* (a *liquid* investment is one you can sell it quickly and with low fees) and *safe* (you are unlikely to lose your principal), but it won’t offer much *growth* (growth is when the value of the investment compounds over time).

“Or her stream of income could offer *liquidity* and *growth*, but it will be volatile.

“Finally, an investor could acquire a stream of income that has both *safety* and *growth* but it won’t be liquid.

“You can see that there is a decision tree here. The primary choice an investor must make is between liquidity and illiquidity. But it’s not like the investor has to put all her money into one type of investment. She could put some money in a liquid investment and other money somewhere else.

“Obviously, a portion of your money should be placed in some sort of liquid investment. We’ve all seen the tragedy that results when folks owning several apartment buildings – but with absolutely no cash under the mattress – get hit with an unexpected emergency. Maybe those shoes you *really, really* want go on sale. Or your eldest grandchild, the one with the suspect DNA, has to be bailed out again. There might be any number of occasions when cash under the mattress becomes terribly useful, if not to you then to someone you care about.

“Most of your liquid funds, of course, should not be in cash. It’s alright to have *some* cash hidden in a safe spot, but dollar bills don’t breed in the dark. Once you have emergency cash under the mattress, you have to invest the rest.

“When you invest liquid funds, the first decision is whether it is more important for you to buy *safety* or to buy *growth*.

"If you think interest rates will be trending up over an extended period, and you're not comfortable with stocks, you might want to put some money into a short-term bond fund, perhaps one with low annual costs. Personally, I've never cared much for bonds, but there are a lot of folks who do. There are bond mutual funds that invest in short term U.S. Treasury Notes, rolling the monies over upon maturity. These funds offer security – the only thing safer than short-term U.S. Government obligations is a puppy's love – but no real hope for meaningful growth of principal.

"Alternatively, you can put your liquid funds into stocks. There are blue-chip companies that offer high dividend yields as well as some expectation of an eventually improving stock price. Any stock broker could provide you with a list.

"You might not feel comfortable buying individual stocks, but still wish to place some of your liquid money into the market. In that event, it seems pretty difficult to do better, over the long term, than a low-cost Standard & Poor's 500 Index Fund. This is a mutual fund that purchases shares of stocks in the 500 largest public corporations in the United States, and pretty much tracks the stock market as a whole. So you could probably expect an investment in something like this would, over time, do about as well as the national economy.

"So there you have three possible homes for your liquid funds. If you think you'll need the money soon, you should probably put it into a short-term bond fund. This is a *"liquid – safe"* investment.

"If you expect to leave your money in place long enough for compounding to become meaningful you could select *"liquid – growth"* investments. These would be either individual stocks or the stock mutual fund of your choice. The business magazines typically have annual ratings of mutual funds, and you could pick from one of their recommendations. Or, as a default selection, you may elect a good S & P 500 Index fund. Many people think that investing in a mutual fund is much safer than individual stocks. The reason, they say, is that your money is diversified among such a wide number of well-established companies that the overall risk factor is considerably reduced. Personally, I think they might have a point. This sort of investment seems to occupy the middle ground between the safety of bonds and the volatility of individual stocks. I hope we can have a fuller discussion of S&P Index funds the next time we meet.

"Once you are comfortable that you have enough cash and cash-equivalent assets that you are *very* unlikely to be forced to sell one of your *not-liquid* investments at a distressed price, you can begin to acquire illiquid assets, like income properties.

"Income properties are both safe (anytime a bank, with many years of institutional experience will lend you 75% or more of the purchase price, you know they think it's a safe investment) and offer growth of your invested dollars.

"The growth potential in income properties comes primarily from two sources. First, there is the expectation of increasing cash flow as you raise the rents over time. Secondly, each mortgage payment reduces the balance on the mortgage and that is kind of like a 'forced savings' that will eventually benefit you. Somebody once said that you can tell how much an investor will be worth in 30 years by how much *investment debt* (not consumer debt) they owe today, and there is some merit to that."

"What is *investment debt*?" I asked.

"If you have consumer debt, you have to pay it off yourself", she answered. "Investment debt is paid off by others. The most common type of investment debt is a mortgage on income property. You own the property, but the tenants pay it off."

"So there you have it. What do investors do? They buy streams of income to best suit their personal situations. The income streams have one of three possible benefit packages. They can be liquid and safe. They can offer liquidity and growth. Or they can be illiquid but promise both safety and growth. You mix and match your investments to achieve a comfort level that lets you sleep at night.

She looked at me and seemed to read my mind. "I think I know what you're thinking," she said. "We'll get to your 14%, but first, now that you have a little background, we need to talk about stock mutual funds. The reason is that while most of your assets may very well be in illiquid investments, you will need to have some liquid funds. And you want those liquid funds to be working for you. A mutual fund is one of your alternatives". *Continued next month ...*

Klarise Yahya is a Commercial Loan Broker. If you are thinking of refinancing or

purchasing five units or more anywhere in the U.S.A., Klarise Yahya can help. Find out how much you can borrow! For a complimentary mortgage analysis, please call her at (818) 500-9966.