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In order to succeed you must first survive

Blog

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We had the first of two US-based CIO forums (Risk: From Chance to Choice) this week in Los Angeles, California. One of the questions Mike Ryan (CIO, Americas) asked as part of the investment and portfolio strategy panel was "Why is a Liquidity strategy important?" My answer:

If you don't take anything else away from the day please remember this: "In order to succeed you must first survive." Compliments to Warren Buffett and Nassim Taleb for the quote. They both frequently make this point. It's true for investing, running a business, and life. To put a point on it, any investment strategy with even a small chance of failure (or financial plan, for that matter), will eventually fail. We can never forget that.

A Liquidity strategy is important because it keeps that concept, survival, front-and-center. We define it as enough safe assets to cover your spending for long enough to get you through a market crisis – likely 3-5 years. It's a part of the portfolio that you can spend down during a crisis, and then build back up during better times.

It's also something that many successful institutional investors use. For instance, David Swenson at Yale believes sizing a Liquidity strategy is one of the most important metrics they look at for the endowment:

> "So we're absolutely not market timers, but I would talk about market timing as kind of a short-term swing in the portfolio to take advantage of some knowledge that you have or some belief that you have about where markets are headed in the short term. But I think we have to take strategic positions in the portfolio. One of the most important metrics that we look at is the percentage of the portfolio that's in what we call uncorrelated assets. And that's a combination of absolute return, cash, and short-term bonds. And those are the assets that would protect the endowment in the—in the event of a market crisis."

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Appendix

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