Liquidity (4 min)

If your company truly succeeds, you will likely find yourself equity rich but still cash poor. It is essential to create liquidity and diversify out of your company's stock. The general rule of thumb is to have no more than 25% of your net worth in "alternative assets" (illiquid assets). Because your company's equity is likely the majority of your net worth, your net worth is likely >95% alternative assets. It will be close to impossible to sell 75% of your stake in your company. Instead, know that two absolute numbers are significant. $10 million and $100 million.

Most people at $10 million of liquid net worth have the feeling of safety. They breathe a sigh of relief. They are no longer at risk. However, once they sit with that number for a while (and start to raise a family), their mind begins to play through disaster scenarios of how that net worth could disappear altogether. Once their liquid net worth grows past $100 million, the catastrophe scenarios dry up, and a sense of abundance follows. This level is what you are driving for.

The reality is that $10 million is more than enough to live an extraordinary life. But give the mind what it wants. After $100 million, each additional dollar will likely not add in any way to your life and may well create a burden (if you buy assets that need to be maintained and supervised).

Therefore, as soon as your company's equity begins to have significant value, start to sell to secondary share buyers until you have sold $10-100 million.

Note: Some investors believe that fear is the best motivator. Therefore, they do not want you to get any (or at least not meaningful) liquidity until they maximize the company's value. I believe that joy is a much better motivator than fear, and therefore I take the opposite view on founder liquidity.

Bank versus Brokerage

The next question becomes: Where do I put the $10-100 million?

You have three choices:

1. Commercial Bank (i.e., Citibank)
2. Investment Bank (i.e., Goldman Sachs)
3. Brokerage (i.e., Schwab)

Holding your money in a commercial bank is a terrible idea. Commercial banks will hold your money and then lend it out to others. The bank gets all of the upsides of these loans, and you bear all of the risks. If the economy tanks and the loans go bad en masse, then the bank fails, and (barring a federal intervention) all of your assets go to pay off the creditors of the bank itself.

Investment banks are similar to commercial banks in that they will use your money to generate profits for their own account. The only difference is that investment banks are not restricted to loans. They can make any kind of bet or investment with your assets. The bank receives all of the upsides while you bear all of the risks. Again, it is a terrible idea to hold your money at an investment bank.

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Finally, there are brokerage firms (i.e., Schwab, Fidelity). These firms do not make loans or investments on their own account. Whatever assets you place at a brokerage firm remain in your name, are only invested in the way you direct, and remain the sole beneficiary. That being said, a brokerage firm is still a business and can go bankrupt if its expenses exceed its revenues for an extended time (though this is much less likely than at a bank that is almost sure to go bankrupt in a sharp economic downturn). In that case, your assets do get tied up in bankruptcy court, with one exception: US Treasuries. US Treasuries are never held in custody. They are always held for the beneficial owner. If the brokerage firm were to go bankrupt, your US Treasury certificates would be sent directly to you and not held by the bankruptcy court.

So, start by placing your liquid assets in a brokerage firm. Then invest all of the cash into US Treasuries while you decide on your investment strategy.

Investing

Now that the money is in a safe place, how do I invest it?

David Swensen is the Chief Investment Officer for the Yale University Endowment. He is considered the grandfather of portfolio management. He wrote a book specifically for the individual investor entitled Unconventional Success. I believe it is the bible for individual asset management. In it, he convincingly describes how professional money managers who can create alpha are exceedingly rare, and you likely will never meet them. The money managers you encounter will probably never create positive net returns (after they siphon off their fees and carried interest) compared to the public equity markets. Therefore, the best approach is for you to simply invest in low-cost index funds (i.e., Vanguard) according to a specific allocation (he recommends about 35% US Equities, 35% non-US Equities, 5% Real Estate and 25% US Treasuries) and then re-balance as often as possible.

Unfortunately, re-balancing means putting in lots of trades, and that is painful. Luckily, someone built a tool to solve that problem. Wealthfront is the leading auto-rebalancing investment engine. Many others have copied it, but as of 2018, it is still my preferred vehicle. I keep the majority of my liquid equity net worth there.

The only glaring flaw of Wealthfront is that it doesn't yet allow an investor to set a % to hold in US Treasuries. So, those I have at Schwab.

There is a new version of Wealthfront called With Compound that is both low-cost and solves the problem of custom % allocations. Its target customer is the tech founder, with high paper worth and low liquidity.

⭐Interested in coaching or software to help implement the Mochary Method at your company? Please fill out our interest form here, or book a discovery call with Nancy Xu here.

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