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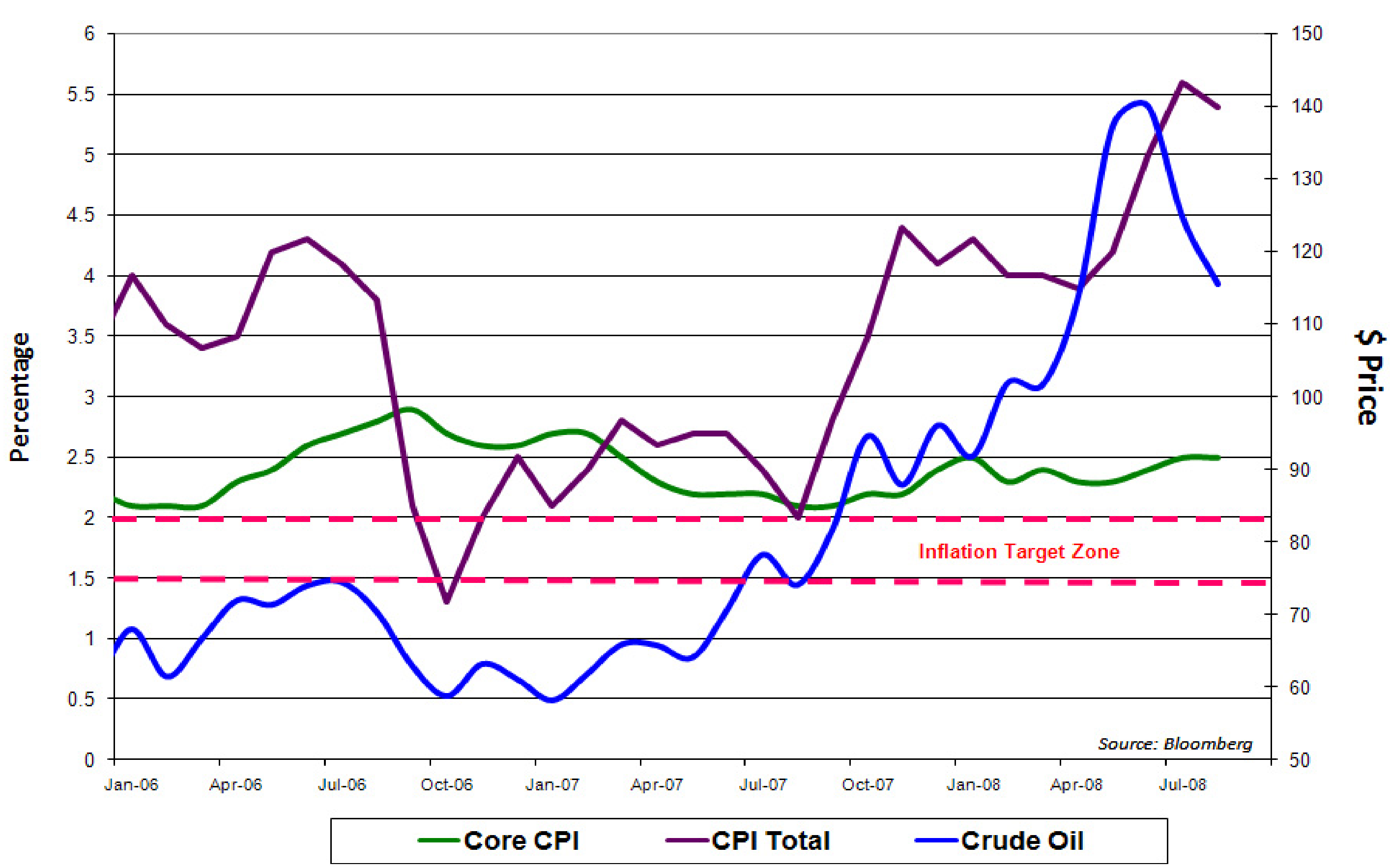
Short Term Investment Strategies Require Change in Today's Environment

By Ryan Leahy
Vice President
Prime Advisors, Inc.

Most people and organizations are feeling the pressure of inflation through higher priced goods and services, and at the same time being paid very low interest on short-term investments. When an investment's future value is lower than its current value adjusted for inflation, it is said to have a "negative real dollar return." The health care industry may be more susceptible than others to this, as it is an essential ubiquitous service. The US Government measures inflation by observing two indices, the Consumer Price Index (CPI), currently at 5.4%, and the Core CPI, currently about 2.5%. Because food and energy are thought to create inflation volatility, these components are removed from the Core CPI number. The predominant measure used by the government is Core CPI, but that measure is argued by many to underestimate inflation (see chart below). The Core CPI target inflation zone ranges between 1.5% and 2%. Furthermore, some items may take time

Key Price Indices January 2006 through July 2008



to "trickle down" in order to realize inflationary pressure; some of these items include bulk purchases, advanced purchases, and hedged inputs.

Historically, health care providers and their advisors were able to use a strategy of short term investments, including money market accounts, to achieve acceptable real dollar returns. The current market conditions have changed dramatically and those maintaining this strategy are feeling the squeeze of small or negative real dollar returns. In addition, recent news shows some money markets are actually breaking the buck, as a "run on the bank" situation is occurring.

Another detrimental strategy is to reduce the credit quality of investment vehicles. Yields are currently at attractive levels, but those yields come with a significant risk to principal, interest, and liquidity. This strategy provides a solution to increase real dollar returns during times of inflation, but at a substantial risk in the current market environment.

Insurance companies rely heavily on their investment portfolio to maintain a profitable business and gain a financial edge. A large component of an insurance company's strategy is asset/liability matching. Regardless of the industry, the strategy is simple: match predictable cash outflows with investment maturities of the same time period to match the cash need.

During periods of inflation, the actual process of asset/liability is much more complicated. The prediction of cash flows and choice of investment vehicles involves the use of statistical data, comparables, historical data, Pro Forma, allocation maximization, and vast investment experience. Although cash flows may have some similarities within industries, individual organizations are unique in their cash outflows, which require customized modeling of cash flow. For a quantifiable example, a $50 million portfolio that generates an extra 0.5%, results in an additional $250,000 of investment income. In a negative real dollar return environment, that same $250,000 would reduce a real dollar loss.

Given today's market, short duration portfolios would run a large risk of negative real dollar returns. Investment policies and guidelines that limit the maturities of investment vehicles to short term and cash vehicles actually increase the risk of portfolio during inflationary periods. Accordingly, current market conditions warrant reviewing investment policies and guidelines to minimize risk and maximize returns.

Otherwise, leaving a portfolio dependent on short term investments could rob it of real dollar returns.

Ryan Leahy is Vice President of Business Development with Prime Advisors, Inc. Prime employs a systematic and disciplined approach to the complexities of managing investment portfolios for hospitals, insurance companies and health plans. Ryan can be reached at ryan.leahy@primeadvisors.com.

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