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Investment Income: 12% Returns for Pension Plan, Foundation & Endowment Investors

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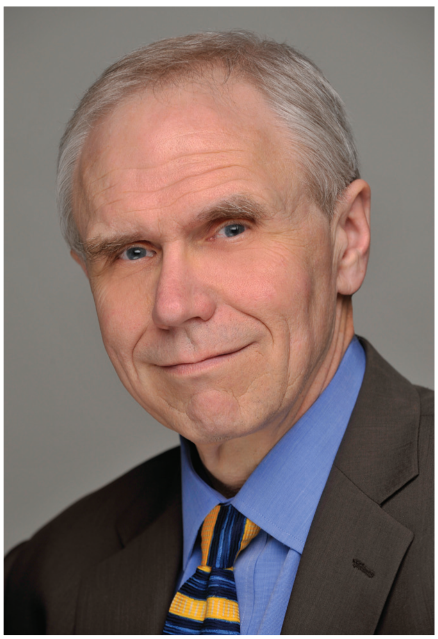

Too Good to be True?

Following last month's columns, several CFOs approached us regarding the potential for risk and return from an income enhancement strategy and their questions related (appropriately) to the increased risks that come along with increased potential for return.

Our readers may recall we introduced the concept of a buy-write strategy that involves the "overlay" of an option management program "on top" of an existing portfolio of equities such as the S&P 500 Index.

The strategy makes it possible for the investor to generate significant income through the use of its long-term equity assets. As noted previously, they give up a portion of the portfolio's potential excess appreciation above a given, predetermined point, in exchange for a current income.

Our closing question in that column went like this: "Would you give up any excess return on your index portfolio (say beyond +25%) in the next 12 months in return for an additional income of 2% (net of management fees) on the portfolio?"

Our callers questioned the risks connected with professionally managed overlay strategies and we were happy to be able to report that it appears that the risks and returns are in alignment and the risks are outweighed when the strategy is used by institutional investors with suitable goals, objectives, constraints and expertise.

Patient Receivables as Investment Assets

As a further example of the power of low-correlation alternative investment assets, there are other investment strategies available to institutional investors that produce even higher levels of return in the form of fixed income payments on portfolios of account receivables from healthcare patients.

The asset in this case is a loan to an operating business that invests in a diversified portfolio of credit-rated patient obligations purchased at a discount from healthcare providers, with full recourse to the hospital.

Benefits for Hospitals

As an element of the hospital's revenue cycle management, the "sale" of such assets converts receivables into an immediate funding source for patient-pay balances prior to the billing and collection of monthly payments from patients. This reduces accounts receivable days and improves cash flow. In addition, the service helps in relationship management with patients and the service community, transforming a growing public relations challenge into a public relations advantage for the hospital.

Collection rates increase, costs of collection decrease and patients are happier consumers.

Benefit for Patients

The credit/collection relationship produces an easy-to-use, extended payment program that finances patient-pay expenses (co-pays, deductibles and uninsured hospital costs that are not eligible for financial assistance, governmental programs or provider reimbursement). Patient anxiety is reduced and the likelihood of a favorable financial outcome is increased. The patient family receives a finance card issued by the service organization in the name of the hospital, with amortized payments, monthly statements and excellent, third-party customer service.

Benefits for Investors

The investment platform provides access to sophisticated investors in the form of one and two-year notes paying double-digit interest. These vehicles have proven popular with institutional investors (defined benefit retirement plans and foundation/endowment accounts) and qualified private investor accounts.

These investments are often referred to as "alterative" as they are not publicly traded, have limited liquidity prior to maturity and are not rated by a third party. Of course, these attributes didn't seem to have much value for investors during the sub-prime melt-down and the resulting impact upon valuation and operations of our financial institutions.

Risks related to these types of investment are generally related to the quality of the assets held by the asset manager/issuer and the ability of management to collect the outstanding balances. Our analysis of the issuer's track record suggests a history of uninterrupted payments and full return of investor principal.

The Bottom Line

Some observers have asked us why they haven't heard about such alternatives through their own advisors, brokers or consultants. That's a good question for next time.

Next Time: Advisors, Brokers & Consultants ("ABCs")

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