EUREKA report

Human capital investing

By Doug Turek
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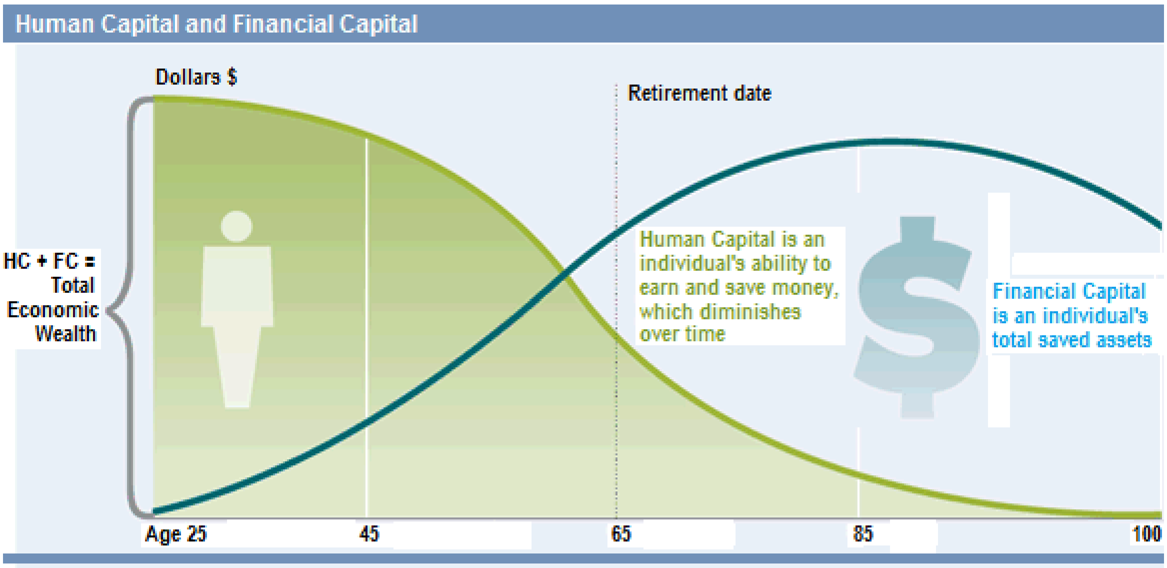
PORTFOLIO POINT: Being the CFO of your career means managing your human, financial and investment capital.

Your work and wealth overlap more than you think. For instance, how you earn a living can influence your investment strategy and many career decisions impact your personal wealth. Let me explore more the concept of Human Capital Investing and offer some ideas for you or your children to help *Make Work Optional*™ sooner.

Allocating your capitals

Nobel Prize-winning economics professor Gary Becker was the first to propose that Human Capital was a legitimate asset class – one earned through study and experience in the workforce and tradeable for income. While this asset diminishes over time, by earning and saving you translate it into financial capital. Asset consultants Ibbotson Associates neatly show this in the following lifecycle diagram.



Source: *Ibbotson Associates*

It follows then that your asset allocation should take account of both of these capitals. The first conclusion to draw is that your ability to take risk with your financial capital is highest when you are young and reduces with age as you become more reliant on it. This is the foundation of lifecycle asset allocation discussed earlier (click **here**) and the maxim “Have your age in bonds”, which I consider a default position for many.

A second conclusion is that the right amount of equities you have for your age also depends on your specific career. If you enjoy a steady and secure income then you can take greater risks with your investment capital and invest more in shares. On the other hand, if your income is variable or uncertain, then you need to invest more conservatively to plan for times being underpaid, temporarily out of work or retired early.

These days it is difficult to generalise on what is a secure income. For instance, a self-employed business owner working in a stable industry with loyal customers may have far more security than the career executive or administrator who is one merger or downsizing away from being made redundant. Even in Canberra, the circumstances of a senior politician in a safe seat, who will later receive a generous lifetime defined benefit

(DB) pension income, would be very different than a new independent in a defined contribution (DC) fund.

Covarying risks

Many years ago I worked for a *Fortune 50* company at their overseas headquarters in a town of 30,000 people, where a third of residents either worked for the company, were family of those who did or provided services to them. I owned a home in this small town, participated in the company share ownership plan, and like Enron employees, had an option to invest all of my 401k superannuation in company shares.

By now you will get the picture that sometimes your income and investments can be too much in the same basket and it is wise to minimise this. The irony is that those working in an industry probably do have a better chance of spotting bullish trends or outperforming stocks in that sector, however, their ability to invest meaningfully is diminished because of these overlapping or “covarying risks”.

This means bankers should be careful loading up on bank stocks, farmers on agribusiness stocks, miners on mining stocks, retailers on retail stocks, investment bankers and stock brokers on stocks in general and real estate agents on property. However, if you have a steady income working as a doctor, dentist, pharmacist or other in health sciences I suspect you can still speculate in biotech and pharmaceutical companies. So yes, your dentist probably can probably take that call from his or her stockbroker while working away on your teeth!

Counter to the trend of executive bonuses being paid more in shares than cash rewards, is the need for executives to reduce their exposure to company shares as those shares vest. It is not uncommon to find a CEO of a firm with more than 50% of their Financial Capital and 100% of their Human Capital tied to one company or industry. Perhaps then published information about executive and director share sales is more a measure of good risk management skills than bearishness on the company.

Hedging your human capital

If you had a machine in your house that ejected $50 notes every few minutes you probably would insure it for breakdown. It is a “no-brainer” then that if you have an income you should have in place a meaningful amount of income protection insurance – that being the maximum or 75% of your salary and a benefit that pays you to age 65, not just for two years.

The after-tax cost of insuring your income is typically 1–2% while under age 55 so choose to:

- Have 100% of your income but if you become ill an unable to earn it get none of it once your short-term sick leave runs out, or
- Live off 98% of your income and if you become ill enjoy 75% of it until you can get back to work.

If you have adult children then make sure they have proper income, death and disability insurance otherwise realise you’re their insurer. Also, if your spouse isn’t working don’t forget to value his or her contribution to the family and the impact on your income earning if they became ill or were to pass away.

The old insurance agent with steel-cap boots has gone the way of the dinosaurs, so you’ll need to proactively address these risks. Take care also when changing jobs to ensure you don’t lose irreplaceable insurances as these days many executives become uninsurable as the stress of work takes its toll.

Is your job a toad?

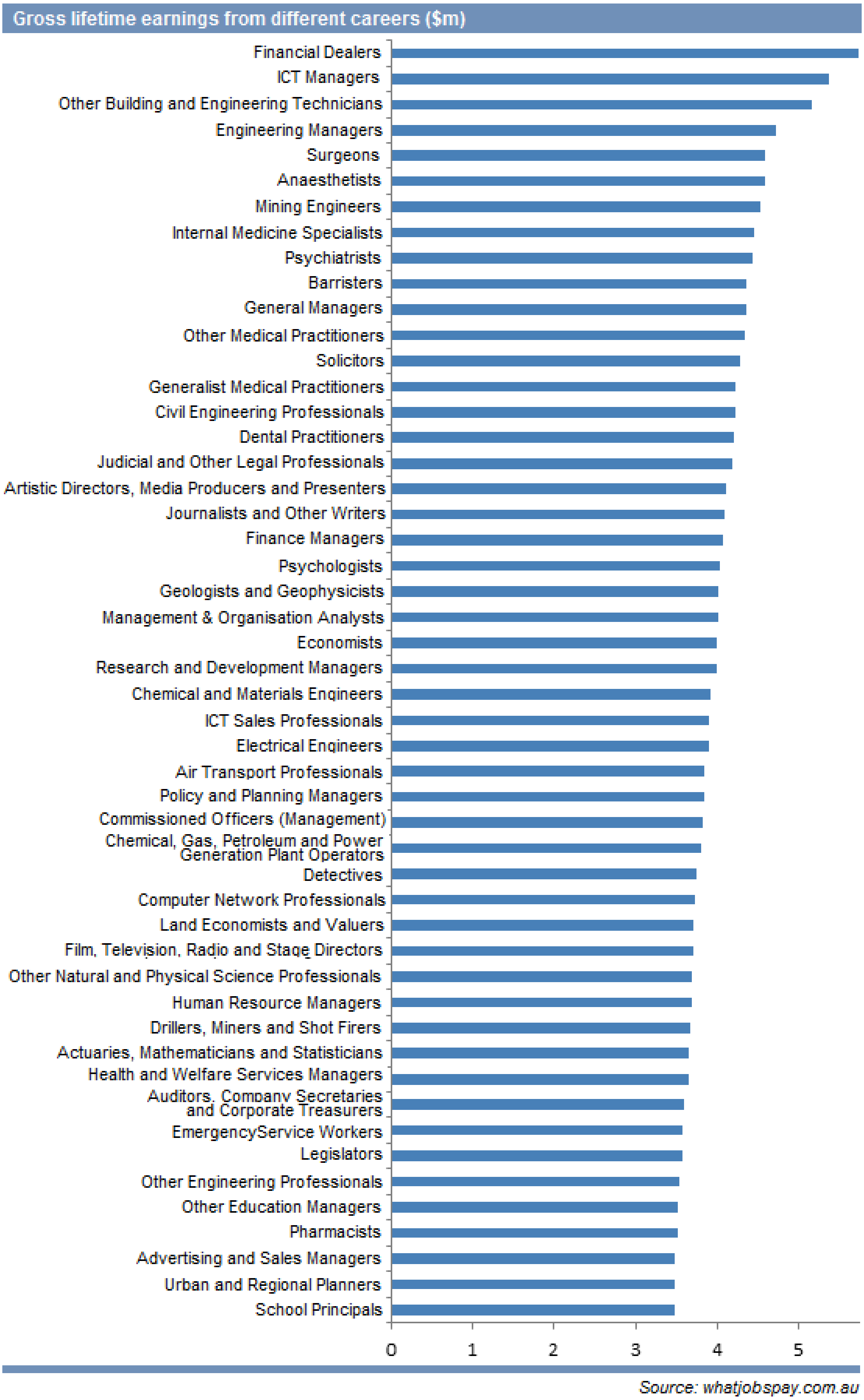
Former stockbroker and author of *Your Money or Your Life,* Joe Dominguez, offered a suggestion that would offend all high school career counsellors, human resource professionals and executive coaches. He said that you might enjoy life more if you sought out the highest paying career rather than the one you love the most – provided you use your extra earnings to buy time to do what you really love.

Many believe in a “Job Charming” and that if they kiss enough frogs, they will ultimately find a princely job – instead he said accept that your job is a toad!

For instance, work as an investment banker three days a week or full-time for a few years, then do hands-on environmental projects outside of work. This could be better than working as a desktop publisher for a pro-environment organisation, writing a newsletter to solicit funds to keep the office running and your salary paid – and never getting your hands green.

The figure below reveals estimated gross lifetime earnings from different careers. While I’ve been wondering whether it would be better to have a plumber and an electrician in the family, rather than a doctor and a lawyer as I once said, these statistics don't support that.

The highest earning professions include financial dealers, IT managers, engineers, surgeons and other medical specialists and barristers and solicitors. The fact that financial dealers top the list and school principals are at the bottom will no doubt stir some social commentary – just please don't shoot the messenger, who incidentally places himself in the lower paid "finance manager" category.



Funds management analogies

Just as in managed fund league tables, there is survivorship bias in *BRW's Rich* List, which does not include the many who simply bought a job or whose start up business failed. From my earlier days contributing to the

Boston Consulting Group's Wealth Report, I learned Australia has an unusually high percentage of executive and professional wealthy (lawyers, investment bankers, consultants and medical specialists).

The risk-adjusted returns from pursuing an executive or partnership career path can often be superior to being an entrepreneur. That was the message that Dr Thomas Stanley, author of ***The Millionaire Next Door***, heard from successful millionaire businessmen when he asked what profession they wanted for their children; most said to become a doctor.

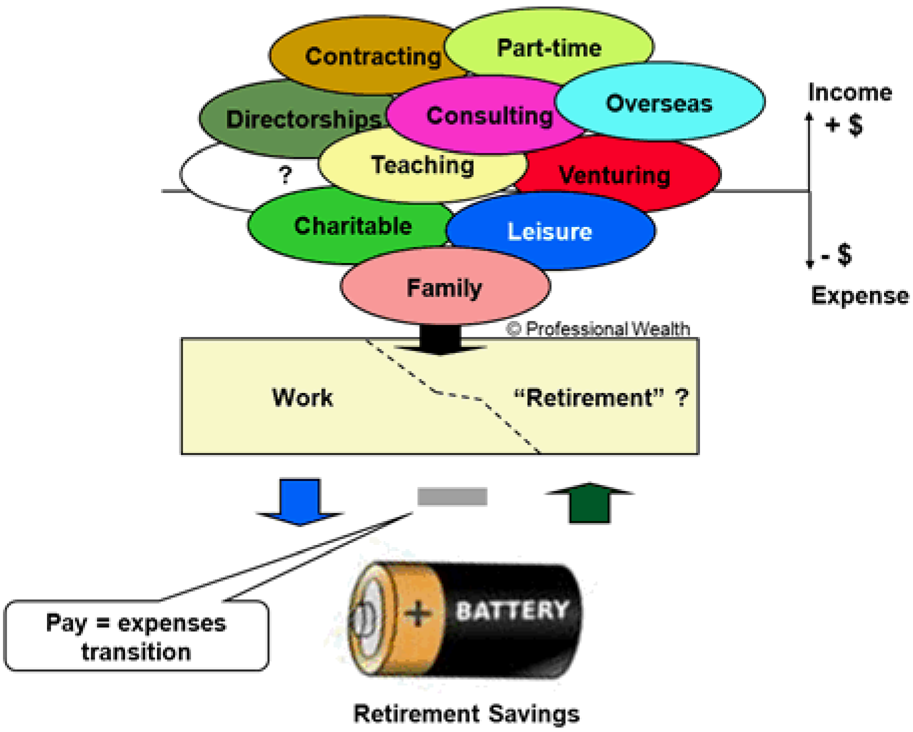
While top-line investment returns and gross income is important, it is also important to look at net after costs earnings. Costs can be monetary, like the costs of housing, education and taxation, but also non-monetary, such as stress at work or commuting and impacts on your marriage and other relationships.

Just as a good financial adviser should be able to add net value to your investment strategy, so should a good career advisor or coach to your career strategy.

Certain career choices create options for future roles that may pay more or offer greater security. For instance, being a CFO may make you more in demand later for **executive interim work** than if you stay a corporate strategist. Building your network and experiences in a small dying industry might limit your options, although sometimes it could help you become a big fish in a small pond, maybe with fewer sharks swimming about.

In addition to constructing an investment portfolio, savvy late career stage professionals cultivate contacts and experiences that enable them to assemble a portfolio career of partly paid and unpaid work to transition to after full-time work (see Figure below). By working for expenses only and not drawing on savings to live, you give your investments the best chance to double in value in seven to 10 years, like it used to in the old days. However be careful to not transition too early, as an Australian Institute report showed that two out of three people who downshifted missed the money.

Portfolio career and interactions with the Work Retirement transition



Being a serial redundant

One of the top categories of wealthy US women is reportedly serial divorcees. It follows that those executives who can set themselves up to be made redundant a few times, preferably through takeovers rather than underperformance, could do well. Redundancy benefits, a form of employer guilt and litigation avoidance, can provide a substantial boost to your personal savings. Monies paid can eliminate your mortgage or boost your superannuation.

Rules that allowed many to reduce tax payable by contributing benefits to super have been tightened, however concessional tax treatments still exist. Many executives need to play a careful game to be packaged out and often need to negotiate favourable exit terms before starting a role.

For many small-business owners, their business is their superannuation. Rich concessions exist to roll over the proceeds of a business sale into super. However, not all business owners have put in place succession plans or a “business will” to ensure death or illness of a key person doesn’t devalue their asset.

For building long-term wealth it is important to minimise periods of unemployment, or less recognised, under-employment. The miracle of compounding savings from earned income requires you to maintain regular earnings and a savings discipline, which is a challenge for many professional women who take time out of the workforce to have children or care for family.

Some of the highest-paying jobs for young professionals, such as investment banking and consulting, have pyramid-shaped career structures, which force some out into under-employment unable to continue their high earning or spending.

Expatriate games

Starting or finishing your career with a stint overseas can be rewarding. However, be careful doing so in the middle of your career as you can create “career re-entry risk”. There are numerous tax savings benefits for Australians crossing borders and it pays to get specialist help to plan each stage of leaving, residing offshore and returning.

Some of these benefits include avoiding investment income and capital gains tax (click **here**), accumulating losses for the future and arranging substantial expense deductions. Managing your asset allocation, currency and superannuation are equally important considerations. In a few cases an employer may also help fund expenses like selling a home you would otherwise incur yourself.

Money isn’t everything and my apologies for breaking many taboos regarding the virtues of work. However as Human Capital is an important asset it warrants the occasional dispassionate view about how to best manage it. You need to be not just the CEO of your career, but also the CFO of it.

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