

Know Your True Worth

Your biggest investment isn't your RRSP or pension.

It's your job **BY MOSHE ARYE MILEVSKY**

My sister-in-law recently lost her job at a high-tech company that went belly-up. Now her employee stock options are nearly worthless as well. While many people have learned the hard way that investing in their employer can lead to poor diversification, most don't realize that they must consider the nature of their job when allocating their financial assets.

Indeed, you should deploy your financial capital to mitigate the risk of your human capital, not to magnify it.

Financial capital is the total of your liquid and investable wealth, while human capital is the present value of all your unearned wages, salary and commissions that you expect to receive during your working life. You can't touch or see human capital, but like an oil reserve under the sands of Alberta, it will eventually be extracted, so it's definitely worth something now.

During the course of your working life, you will convert human capital into financial capital. Thus, your total capital — your true net worth — is the sum of the two components. Therefore, human capital is a legitimate and substantial component of the left-hand side of your personal balance sheet, just as an oil and gas company lists the value of reserves as an asset.

When you're young, human capital makes up most of your total capital, since the present value of all your future wages most likely exceeds the amount you've saved or invested. In the typical Canadian family, whose primary income earner is under the age of 45, more than 90% of total capital is invested in



human capital, while less than 10% resides in financial capital. Even in your early sixties, close to half of your total capital is human capital. (To estimate these numbers, I added up all future median wages until retirement and discounting to the present at an inflation-adjusted rate of 2.5%.)

What good is it to know the value of your human capital reserve, if you can't do much of anything with it right now? Well, if you integrate this asset into your portfolio strategy, you can ensure that your total (i.e., human + financial) capital portfolio is diversified. Simply, when one asset zigs, the other should zag.

For example, for a tenured professor like myself, human capital has the properties of a fixed-income bond fund that discharges monthly coupons. I therefore have little need for fixed-income bonds in my portfolio, which is heavily invested in equities. Thus my portfolio is balanced, even though my financial capital and human capital individually are not. In contrast, the future income of my MBA-finance students will fluctuate depending on the performance of the stock market and the labour market. In other words, their human capital is almost entirely invested in equity, so their financial capital should consist primarily of bonds and GICs early in their working career.

The objective is to make sure your salary and financial portfolio don't share the same zigs and zags. If you work in the bio-tech industry, make sure you own info-tech stocks, and if you work in media, make sure you own some natural resources.

So, next time you sit down to tinker with your financial portfolio, ask yourself: Is my job a bond, or a stock? **B**

In the third quarter of 2001, the average personal savings rate in Canada was 3.3%.

MAKING MONEY THE OLD-FASHIONED WAY

Even for Canadians in their fifties, future job earnings are worth more than their financial portfolios

AGE	FINANCIAL CAPITAL (NET WORTH)	MEDIAN INCOME (AFTER-TAX)	HUMAN CAPITAL (ESTIMATED VALUE)	HUMAN CAP. AS A % OF TOTAL CAP.
Under 25	\$10,300	\$26,000	\$1,133,717	99%
25 - 34	\$47,500	\$40,500	\$1,110,843	96%
35 - 44	\$96,600	\$45,900	\$927,799	91%
45 - 54	\$165,800	\$53,200	\$621,240	79%
55 - 64	\$226,900	\$46,400	\$220,956	49%

Note: based on Statistics Canada estimates for economic families of two or more people; 2.5% discount rate; pensions not included