Where Do Millionaires Park Their Cash?

First, you have to realize that "money" in one sense doesn't exist. It is an idea. If you are talking about the green pieces of paper the Treasury department prints, there is only about $575 billion in circulation yet household assets in the United States are valued at more than $50 trillion.

Think about that. If you owned every single United States dollar bill in the entire world, you would only have 1/100th of the estimated household net worth in the United States. The reason: Those greenbacks are merely an exchange mechanism. They represent something that people can trade to signify a claim check on society. In and of themselves they have no value. We could have just as easily chosen sea shells or jars of strawberry jam. The reason societies have preferred gold and silver over time is they are difficult to mine, so it is very hard for governments, politicians, kings and presidents to make the currency worthless by printing more paper.

The result is that most wealth isn't held in the form of cash. In fact, I think of money as being held in seven distinct forms (there are more but these are the major ones):

1. Business ownership (stocks). If you own a chain of dry cleaners that makes $1 million a year in profit, you could probably sell the company for between $10 million and $15 million. You don't have that money "sitting" anywhere, but it is yours nonetheless.

2. Money they have loaned and must be repaid to them in the future such as bonds, certificates of deposit; money parked in bank accounts, and money invested in money market funds.

3. Real estate, such as hotels, apartments, stadiums, homes, storage units, bridges, etc.

4. Commodities, such as gold, silver, platinum, corn, cattle, mineral rights, oil, natural gas, sugar, coffee, etc.

4. Nominal currencies, such as United States dollars, Euros, Yen, and British Pound Sterling stuffed in envelopes or briefcases.

5. Intellectual property, such as ownership rights to famous songs, books, movies, and photographs. If you owned the rights to Star Wars, you could have no money in the bank but the truth is, you are probably a billionaire because you could sell those rights to a lot of interested investors; they, in turn, could create new merchandise and products and make money from it, which is why they are willing to pay you. Brand names are a huge source of intellectual property value, such as Coca-Cola, Clorox, Wrigley, Hershey's, and Folgers.

6. Tangible property, such as famous paintings, historical artifacts, rare books, etc. If you owned an original, signed copy of the Declaration of Independence, you could convert it into any other form of wealth you wanted, such as nominal currency, which you could then use to transfer your wealth into real estate, or commodities, or any of the other categories.

That means that most of the time, someone with substantial net worth doesn't need to park their money in a checking account. You couldn't steal Bill Gates' $50+ billion from him because it isn't money in a briefcase; it is office buildings, shares of stock, railroads, book copyrights, personal real estate, private jets, rare art ... the list is endless.

Don't Think of "Money" As Being Cash.

This may help explain the perspective of an investor...

It is estimated that there are 1,348,528,420,000 barrels of oil in the ground that have a 90% or greater probability of being drilled and recovered by humans (called "proven reserves"). The current spot price of crude oil is roughly $73. That means that all of the oil in the ground is worth an estimated $98,442,574,660,000. Let's round up and call it $100 trillion.

(For now, let's ignore the obvious fact that if this oil was harvested at once, oil would be worth about 50 cents a barrel because the supply would grossly exceed the demand. At current consumption rates, that is enough oil to meet world demand for 54 years.)

That means if you were to suddenly inherit 100,000 barrels of oil, you would be worth $7,300,000 at today's market prices (100,000 barrels x $73 per barrel = $7.3 million).

If oil rose to $100 per barrel, your assets would rise to $10,000,000. You are now worth an extra $2.7 million! Where did it come from and where is it parked? Nowhere. It is the estimated liquidation value of your oil if you choose to sell right now and the market has enough demand to fill your order without the price falling. You are quoting the value in dollars because, as a United States citizen, those dollars mean something to you. You inherently understand the value of $5 and what it will buy you compared to $20.

If the United States government began to print money so it became worthless, and a loaf of bread that originally cost $5 is now $10,000, your oil may be trading at $146,000 per barrel even though you have gained nothing in purchasing power, giving you an asset value of $14.6 billion. The thing is, your purchasing power would be the same because:

$14,600,000,000 would buy 1,460,000 loaves of bread if each loaf was $10,000 just like $7,300,000 would buy 1,460,000 loaves of bread if each loaf was $5.

That means that, measured in bread as an exchange, the government printing money didn't have an influence on your actual purchasing power. You can still buy the same loaves of bread as you could before hyper-inflation. This is one of the reasons famous investor Warren Buffett talks about the importance of measuring gains in your net worth in "how many cheeseburgers you can buy". Purchasing power counts. Not dollars.

What Do The Rich Do With Their Cash?

If you are specifically interested in what the rich do with their short-term cash, comparable to the middle class putting money in a checking or savings account, there are several popular alternatives to those with at least a few million dollars:

Establishing a so-called zero-balance account. The rich investor has his or her money in bonds, certificates of deposit, commercial paper and other highly liquid debt instruments. They write checks out of the account, which has $0 in it, and at the end of the business day, the private bank sells off enough of the highly stable, liquid investments to wipe out the negative balance in the account, bringing it back to $0. That way, if the bank fails, it doesn't hurt the investor because the underlying assets are held in his or her name, not the name of the institution. (This service is known as custody or, in some cases, global custody. The banks will charge a small fee for it as a percentage of assets in most cases.) Almost every intelligent rich person on the planet uses some form of global custody because you don't want to worry about losing your shirt because a broker failed.

Parking the money directly with the United States Treasury in an account backed by the taxing power of the United States government. They can buy short-term Treasury bills and keep rolling them over until they need the money. Unless the United States goes bankrupt by hyper-inflating, they are safe. Buffett literally has tens of billions of dollars of Berkshire Hathaway's money parked in Treasury bills, bonds and notes at times. There is no risk of default or bankruptcy unless the entire nation goes bust!

Physically holding cash in multiple currencies in safe deposit boxes throughout the world. These aren't insured, though, so there is that risk.

I hope that helps you understand how a lot of private banks such as Northern Trust think about parking money for millionaires and other rich investors.

By Joshua Kennon