“Precautionary Savings with Risky Assets: When Cash is Not Cash”

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Abstract

We hand-collect data on corporate reserves and find that 40% of total reserves, or 6% of total book assets, are held in risky assets. Furthermore, 35% of total reserves are illiquid. While firms’ safe reserves can be explained by a precautionary savings motive, their risky and illiquid reserves cannot – they are concentrated in large, profitable firms, with excess reserves and low cash flow volatility. We assess the optimality of this strategy and show that investors discount the value of a marginal dollar allocated to risky reserves. We conclude that this activity represents a tax-disadvantaged asset management industry of more than $1.5 trillion.

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