Uses and Abuses of Liquidity
Grant's Interest Rate Observer 10/22/13

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- What is Liquidity? The ability to realize (or be) cash.
- Broadly, liquidity comes in two forms :
  - Natural : income, maturity or a transaction process inherent in the investment.:
  - Transactional: the ability to sell , or to a much lesser extent , hypothecate , an investment
- Liquidity is dynamic
- Liquidity is contextual e.g.
  - Investor size
  - constraints
  - Capital terms
  - Sufficient Liquidity with a margin of liquidity "safety" is optimal.
- Excess liquidity is benign (if it isn't over-utilized); but irrelevant
- Illiquidity may be ; but is not necessarily , associated with potential additional return
- Inexpedient liquidations of positions detract materially from long term returns and are among the greatest perils facing investment management businesses.
- Nevertheless, Liquidity needs to be managed intelligently both as an opportunity and as a risk.

Ratio of Lennar Corporation Class A vs. Class B

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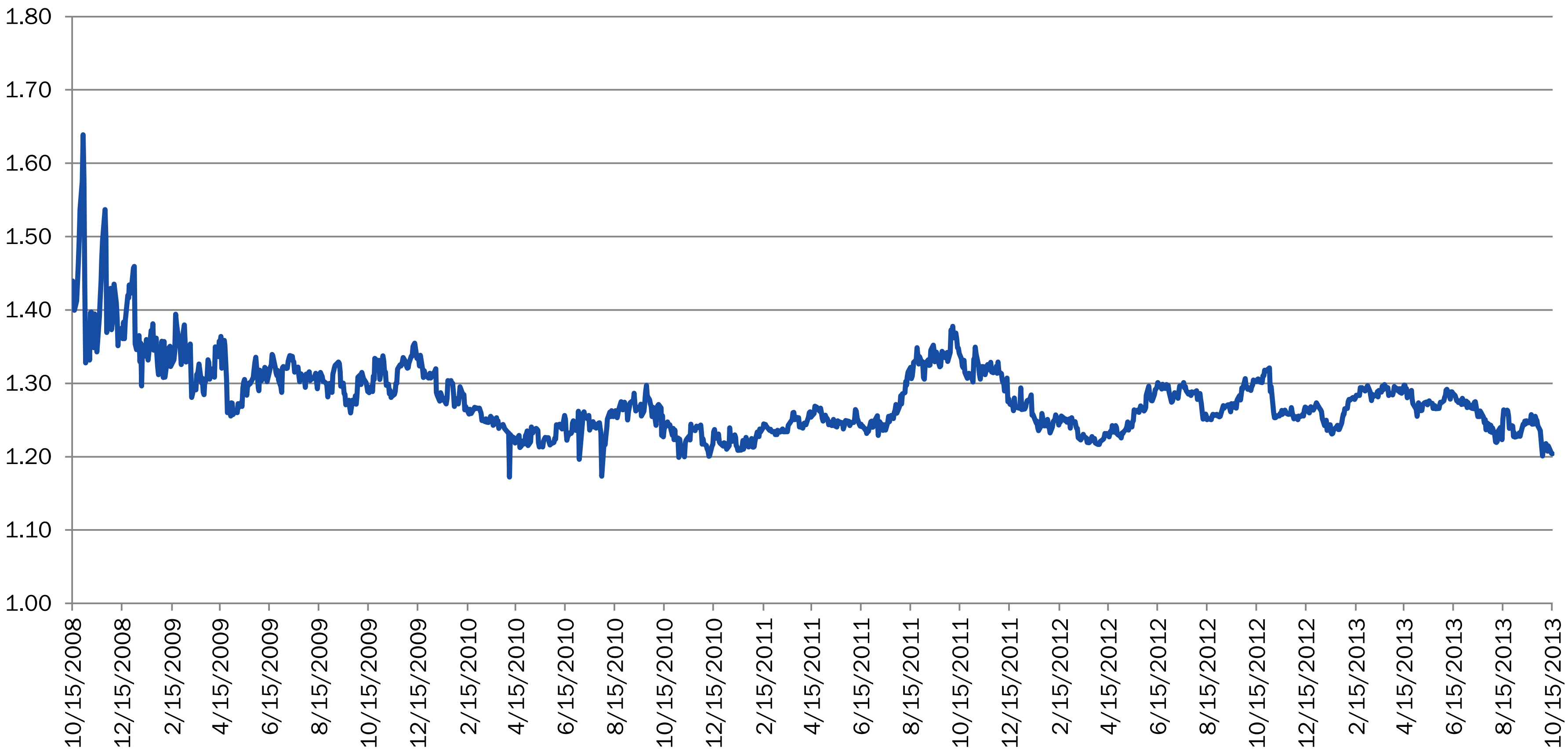

The Price of illiquidity : The case of Lennar

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- Lennar (LEN and LEN/B) is a leading U.S. homebuilder
- Per the 2012 Lennar 10-K pg 115 "The only significant difference between the Class A common stock and the Class B common stock is that class A common stock entitles holders to one vote per share and the class B common stock entitles holders to ten votes per share".

–	Class A	Class B
Price 10/16/13	$33.94	$27.80
Shares outstanding ("mm)	163.1	31.3
Share float ('mm)	157.8	9.8
Mkt cap ('mm)	$5,523	$870
Short interest ('mm shares)	32.9	.08
Avg. daily volume ('mm shares)	5.64	.054
Market value avg daily volume ('mm)	$191.4	$1.5
Max size @ 20% of 10 day avg volume ('mm)	$382.8	$3.0
S &P 500 Index constituent	Yes	No
Listed options?	Yes	No

Outright long : A or B depending on spread and investor size

Outright short : short A , long puts on A or sell A calls

"Indifference zone on B" : Long B , short A calls -current atm call premium 3.5-4% per month. The A strikes may be adjusted depending on directional opinions and A/B changes.

P&L = Δ B +Δ A+Σ A premiums

If the B holding period exceeds a year , ΔB will implicitly be long-term and (Δ A +Σ A premiums) will be short term.