

Express News – July 2009
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There are principles of investing that are based upon rigorous academic research and thought. They can form the basis of an investment plan that can carry someone through the kind of chaos we witnessed in 2008 and early 2009. This is, however, not nearly as simple and straightforward as it sounds, because these principles deal with a free market. And, sometimes, a free market can be most uncomfortable. Let us consider a few of these principles.

First is asset allocation. In 1991 I saw a simple pie chart which outlined the key factors which are determinants of investment outcome. The chart accompanied an article in a scholarly journal published by a financial analyst organization. Simply and dramatically it showed that the one factor to which 91% of investment outcome could be attributed was asset allocation; the way that you choose to diversify your assets. Interestingly, only 5% of investment outcome could be attributed to security selection and 2% to market timing. These three percentages, 91%, 5%, 2%, have always brought to my mind a glitzy casino.

If you stop and think about a casino you will realize there is only one way it can stay in business. The vast majority of its customers must lose! So, what does management do? They have huge signs with ornate lighting and audio that will signal the entire room when someone wins a huge jackpot. And that celebrating explosion is actually saying, "Hey, folks, we just had a one-in-ten thousand event and this guy won a \$500,000 jackpot!" Except, of course, they don't highlight that it's one- in-ten thousand.

In the world of investing we can often see, with, of course hindsight, great purchases or short sales or liquidations that hit a jackpot. But, if you pay attention, it's exceedingly rare to see two such events or calls in a row.

Now consider asset allocation. I always say that the main reason people buy bonds is that they cannot stand the volatility of an all-stock portfolio. Then they guess as to how much to put into bonds and that's usually 40% to 50% of their assets. The result will be a portfolio that is much less volatile than if it were all-stock and whose return will be, perhaps, 85% of what the stock market produces over time. That's one essence of asset allocation.

We have, in 2008 and early 2009, been through a horrible stock market. It dropped about 50% in five months. However I saw people who had chosen an allocation with which they were comfortable and had stayed with it. Very interestingly, when they saw that their portfolios declined 16% or 17% while the stock market was down 50%, they stayed calm and hung in there.

I must add one more principle; assure that you understand the things in which you are invested. This proved extremely important in bond portfolios which owned tax-exempt housing issues. As the mortgage business imploded in 2008, these tax-exempt housing bonds were caught up in the panic associated with sub-prime loans and their prices plummeted. But, if you understood these were not subprime loans, then you held on and have watched them recover.

Then, beginning in March of this year, your asset allocation had led to a significant recovery. All it took was to be a studious, calm and boring person. I think my wife would heartily agree with that last adjective.