eResearch

Third Party Research June 20, 2018

Biiwii Commentary

***e*Research Corporation** is pleased to provide an article and video, courtesy of Biiwii.com, and written by Charlie Bilello (link to the Author is provided on the following page).

The article, starting on the next page, is entitled: **“Diversification and the Fear of Missing Out (FOMO)”.**

Biiwii.com was created in mid-2000 solely as a way to help get the message out about deeply-rooted problems about too much debt and leverage within the financial system. The concerns were confirmed and the message proved justified 3 to 4 years later as the system began to purge these distortions, resulting in a climactic washout extending from October, 2008 to March, 2009.

Along the way, a geek-like interest in technical analysis, a long-time interest in human psychology, and various unique macro market ratio indicators were added to the mix, with the result being a financial market newsletter (and dynamic interim updates), Notes From The Rabbit Hole (NFTRH) that combines these attributes to provide a service that is engaged and successful in all market environments by employing risk management first, and opportunity for speculation second.

But It Is What It Is: You can access Biiwii at its website: **www.biiwii.com**.

Notes From The Rabbit Hole: You can access NFTRH at its website: **www.NFTRH.com**

***e*Research** was established in 2000 as Canada's first equity issuer-sponsored research organization. As a primary source for professional investment research, our Subscribers (*subscription is free!!!*) benefit by having written research on a variety of small- and mid-cap, under-covered companies. We also provide unsponsored research reports on middle and larger-sized companies, using a combination of fundamental and technical analysis. We complement our corporate research coverage with a diversified selection of informative, insightful, and thought-provoking research publications from a wide variety of investment professionals. We provide our professional investment research and analysis directly to our extensive subscriber network of discerning investors, and electronically through our website: www.eResearch.ca.

Bob Weir, CFA
Director of Research

Note: All of the comments, views, opinions, suggestions, recommendations, etc., contained in this Article, and which is distributed by *e*Research Corporation, are strictly those of the Author and do not necessarily reflect those of *e*Research Corporation.

Diversification and the Fear of Missing Out (FOMO)

By Charlie Bilello

June 20, 2018

Diversification is often said to be the only "free lunch" in investing, delivering superior risk-adjusted returns over the long run. So why doesn't everyone do it? Let's take a look …

Responsible financial advisors across the country are apologizing to their clients for the seventh year in a row. Why? Because the diversified portfolios they have built are lagging U.S. stocks … for the seventh year in a row.

Total Returns, 2012 - 2018 (Data through 6/18/2018)											
Category	Ticker	Stocks/Bonds	2012	2013	2014	2015	2016	2017	2018 YTD	Cumulative ('12 - '18)	Annualized ('12 - '18)
S&P 500	SPY	100/0	16.0%	32.3%	13.5%	1.2%	12.0%	21.7%	4.5%	151.1%	15.3%
Aggressive	AOA	80/20	15.0%	22.4%	6.7%	-1.1%	7.8%	20.1%	0.8%	93.9%	10.8%
Growth	AOR	60/40	11.4%	15.7%	7.0%	-1.1%	6.7%	15.8%	0.1%	68.8%	8.4%
Moderate	AOM	40/60	8.4%	10.2%	5.3%	-1.3%	5.7%	11.6%	-0.3%	46.1%	6.0%
Conservative	AOK	30/70	6.4%	6.6%	4.0%	-1.0%	5.0%	9.7%	-0.8%	33.5%	4.6%

Data Sources for all charts/tables herein: Bloomberg, Stockcharts.com

Any way you look at it (from a conservative to aggressive allocation), diversified portfolios have failed to keep pace with the juggernaut known as the S&P.

"Why aren't we holding more of this S&P thing?" clients ask. "Don't you know it is working the best? Even a monkey could see that."

Indeed, and dart-throwing monkeys can be pretty good investors at times …

> *"A blindfolded monkey throwing darts at a newspaper's financial pages could select a portfolio that would do just as well as one carefully selected by experts." – Burton Malkiel*

> *"Malkiel was wrong. The monkeys have done a much better job than both the experts and the stock market." – Rob Arnott*

But I digress.

<continued>

The ratio of U.S. stocks to the rest of the world is at a new all-time high. While the S&P 500 has gained 150% since 2012, the MSCI World, excluding the U.S.A. (ACWX) is up only 55%.

<continued>

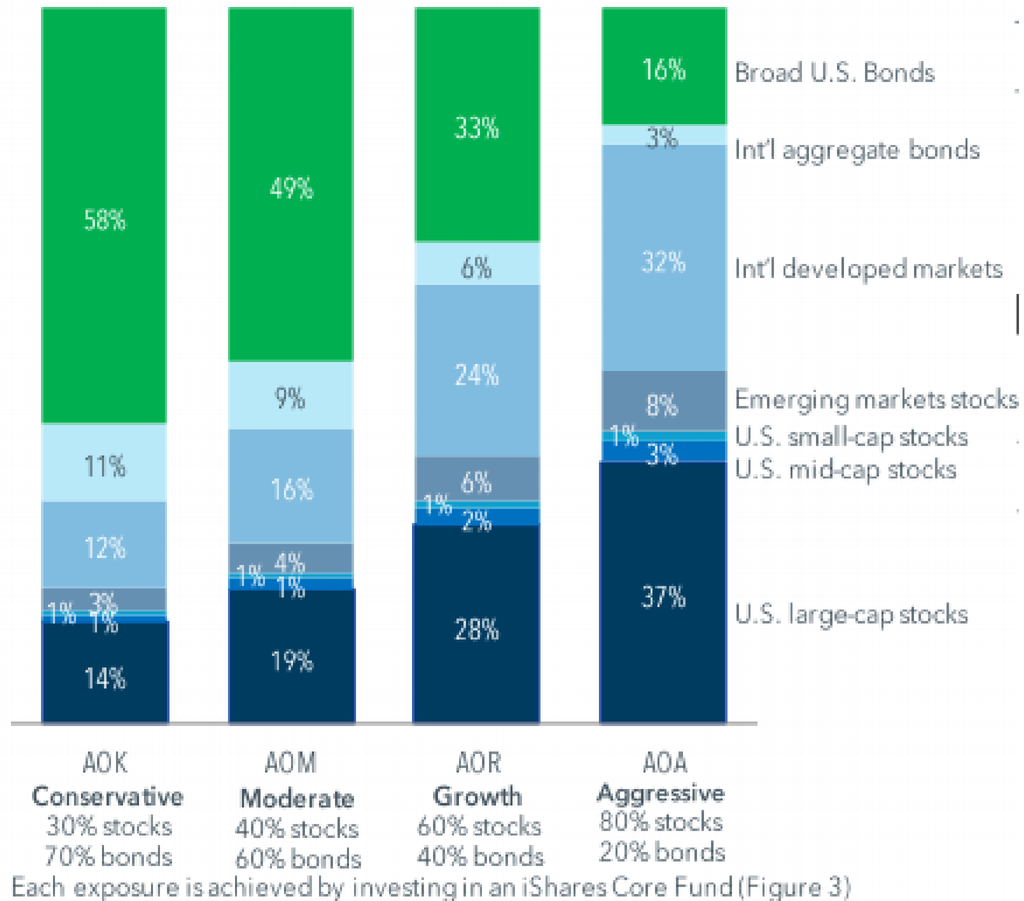
Compared to bonds, the gap is much wider, as the largest U.S. bond ETF (AGG) has generated a paltry 1.9% per year since 2012 versus 15.3% for the S&P 500.

So why doesn't everyone diversify?

Because diversifying means there will always be an asset class beating you. Today, that asset class is U.S. equities and the fear of missing out (FOMO) on further gains is palpable.

Over the past seven years, the following asset classes have all massively trailed U.S. equities: International bonds, U.S. investment grade bonds, U.S. Treasuries, Asia-Pacific stocks, European stocks, and Emerging Market stocks.

Among the iShares asset allocation ETFs, U.S. equities make up just 41% of the most aggressive portfolio (AOA) and only 16% in the most conservative portfolio (AOK). It is mathematically impossible to keep pace with an unrelenting run in U.S. stocks when you own anything other than U.S. stocks.



Does that mean investors should abandon diversification and succumb to FOMO, putting 100% of their portfolio in the S&P 500?

- Only if they are 100% sure that the next seven years will look exactly like the past seven (unlikely, as the S&P 500 has out-performed the MSCI World ex-US Index in just over 50% of calendar years, little better than a coin flip).

- Only if they can handle significantly higher volatility (since 2012, the S&P 500 has an annualized volatility of 13% vs. 6% for the AOM moderate allocation ETF – and this has been among the lowest volatility periods in history for U.S. equities).

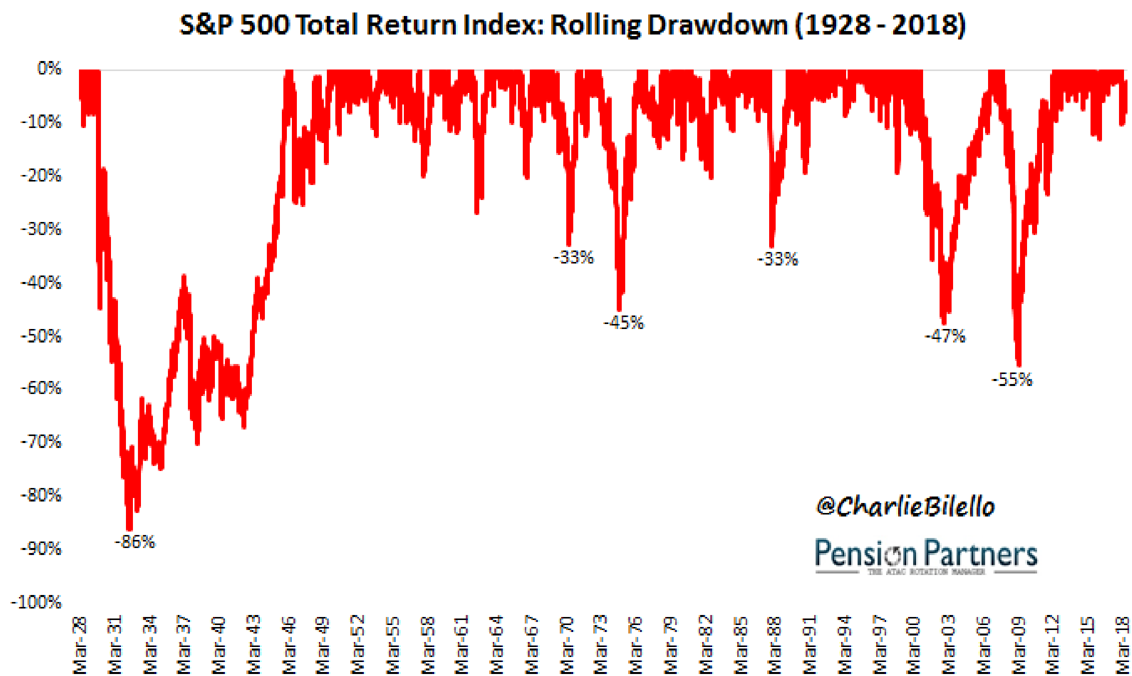
- Only if they can handle much higher drawdowns (the S&P 500 lost 37% in 2008 vs. 10% loss for a 40/60 allocation to US stocks/bonds).

Of course, no one can be *sure* of what will happen over the next seven years and few can *handle* higher volatility/drawdowns than their risk tolerance suggests.

Which is why we diversify in the first place: to protect ourselves from the unknowable future and the visceral responses we all have to volatility/drawdowns. That protection is nothing to apologize for, even if it means massively under-performing the S&P 500 over a seven-year period. To the contrary, it is to be commended. It is far easier today to give in to your clients' demands and take a punt on the S&P 500 than it is to defend diversification. But defend it you must if you wish to remain a professional in this business, for a large part of what you are being paid for as an advisor is protecting your clients from themselves.

Anyone can go out and buy the S&P 500; the problem is that few can stick with it through the ups and downs. Regardless, the S&P 500 is not your benchmark as an advisor; your benchmark is helping your clients meet their goals by taking the highest probability path. That path necessarily *includes* diversification and e*xcludes* betting the ranch on any one stock or asset class.

Your clients may not remember the last time the S&P 500 had a down year (2008) or care to learn about historical drawdowns, but it is your job to educate and remind them. For if you don't it is only a matter of time before FOMO gets the better of them.



<continued>

Biiwii/NFTRH on the Web

NFTRH and Biiwii.com commentary and technical analysis have regularly been published, highlighted and/or quoted at SeekingAlpha, Investing.com, MarketWatch, Yahoo Finance, Ino.com, TalkMarkets and many more since 2004.

Biiwii.com is proud to be included in the **50 Blogs Every Serious Trader Should Read** from TraderHQ.com.

Biiwii: but it is what it is

NFTRH: Notes From The Rabbit Hole