ABR Dynamic Funds' Series on Stagnation Solutions: Part 9

Conclusion

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The conclusion can be summed up in one word: *diversification*.

In installments 2-5, we presented several ideas for U.S. equity replacements with the potential to outperform equities in certain market environments, perhaps environments such as decades of low equity returns. These ideas had return profiles generally similar to the return profile of the S&P 500. Then, in installments 6-8, we presented several ideas for allocations which may be well-suited to complement equity allocations. These ideas had return profiles generally quite different from the return profile of the S&P 500.

To explore these ideas, we used the decade from 2002-2011. At the beginning of that decade, the S&P 500 Shiller cyclically-adjusted price to earnings ratio (CAPE) was approximately 30, much like it is at the time of this writing. Over that decade, the S&P 500 generated an annualized return of 2.9%, in-line with long-term historical results.

However, that is not an indication that we think the next decade will play out precisely like the decade from 2002-2011. We have no idea, and we don't really think anyone else does either. It is unlikely that the best performing idea from 2002-2011 will be the best performing idea from 2020-2029. Still, though, that doesn't mean we can't learn anything from 2002-2011. As Mark Twain is credited with saying, "history doesn't repeat itself, but it often rhymes."

But there are limits to what we can learn. Barring impressive luck, diversification has worked better than concentrated bets into the best past performers. That may not come as a surprise, but what is more noteworthy is that diversification has worked better even than concentrated bets into many well-researched ideas for the future. Daniel Kahneman wrote that "people who spend their time, and earn their living, studying a particular topic produce poorer predictions than dart throwing monkeys…." These expert results are poorer not because experts know less than monkeys, but because experts are overconfident and lose sight of the only free lunch in investing, diversification.

Notes/Disclosures

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