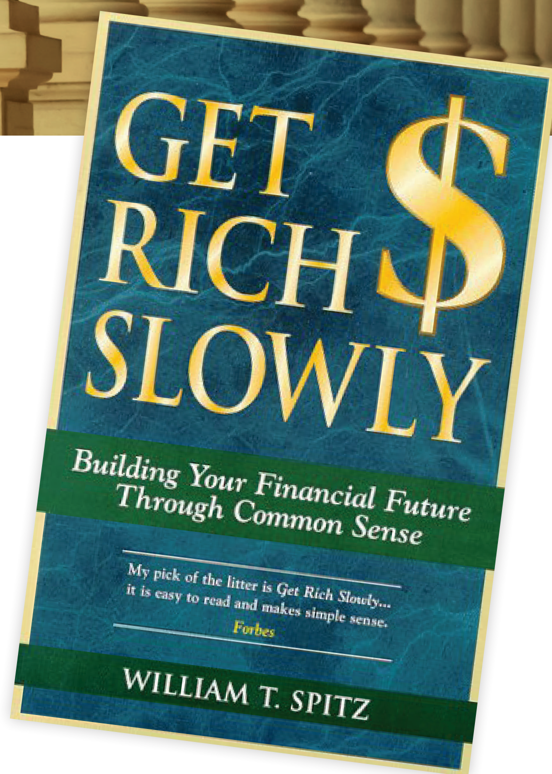
WHITE PAPER



Holy smokes, this finance stuff *actually works!*

In 1992, I published an investment book called Get Rich Slowly that was designed primarily for individual investors. As you will see in a moment, the gist of the book should be very familiar to Diversified Trust Clients and friends because the principles underlying its recommendations helped form the investment philosophy that our firm employs. Now that more than twenty five years have passed, I think it is worthwhile to evaluate the performance of the portfolios that were recommended in the book to see if they behaved as expected. My goal is not to engage in either self-congratulation or flagellation (depending upon the outcome of the study) but to hopefully lend some credence to the investment approach that Diversified Trust and I have advocated over the years.

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The Essence

I will spare you the work of reading 250 pages by summarizing the key points which were as follows:

- **Determine your return goals and risk constraints carefully based on overall financial goals, age, income, and other personal circumstances.**
- **Select a globally diversified asset allocation that seems likely to achieve the target return within the confines of an appropriate risk level. To achieve these goals, the portfolio should contain investments designed to perform well in various economic and market environments.**
- **Use low cost, passive investment vehicles unless you have confidence in your ability to select and access top flight asset managers.**
- **Rebalance your portfolio periodically to ensure that the actual portfolio weights conform to your target asset allocation.**
- **Adjust your goals and resulting asset allocation over time as your financial circumstances change.**
- **Otherwise, leave your portfolio alone and avoid the temptation to react to market movements and headlines.**

Sound familiar? Many of the white papers that I have written elaborate at least to some extent on one of these principles.

To achieve these goals, the portfolio should contain investments designed to perform well in various economic and market environments.

Important Notes And Disclosures

This White Paper is being made available for educational purposes only and should not be used for any other purpose. Certain information contained herein concerning economic trends and performance is based on or derived from information provided by independent third-party sources. Diversified Trust Company, Inc. believes that the sources from which such information has been obtained are reliable; however, it cannot guarantee the accuracy of such information and has not independently verified the accuracy or completeness of such information or the assumptions on which such information is based. Opinions expressed in these materials are current only as of the date appearing herein and are subject to change without notice. The information herein is presented for illustration and discussion purposes only and is not intended to be, nor should it be construed as, investment advice or an offer to sell, or a solicitation of an offer to buy securities or any type of description. Nothing in these materials is intended to be tax or legal advice, and clients are urged to consult with their own legal advisors in this regard.

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Implementation

As previously mentioned, this book was designed for individuals and one of my objectives was for the recommended strategies to be available to even very small investors. Therefore, the recommended portfolios included neither illiquid investments nor strategies that may be liquid but on the esoteric end of the scale. Actually, I recommended seven different asset allocations, each with a different level of risk and expected return. I won't burden you with the breakdown of all seven portfolios, but here are three of them ranging from fairly aggressive to rather conservative.

	Aggressive	Moderate	Conservative
Large Capitalization US Stocks	30%	35%	15%
Small Capitalization US Stocks	30	10	0
Non-US Stocks	20	15	5
Total Equities	80%	60%	20%
Fixed Income	**10%**	**25%**	**60%**
Liquid Real Estate (REITS)*	**10%**	**15%**	**20%**
Grand Total	**100%**	**100%**	**100%**

**Or another inflation hedge*

Given the wide array of investment vehicles available today, these mixes seem a bit primitive and simplistic, but they were actually more diversified than most portfolios at the time which were concentrated in US stocks and bonds.

Report Card

Once again, there were seven portfolios with number one being the most aggressive and seven the most conservative. By way of context, Number 1 was designed for a younger investor with a very long time horizon and the ability to recover from temporary market declines. At the other end of the spectrum, Number 6 was deemed appropriate for a retiree because it was expected to generate considerable income while also hopefully generating enough total return to offset inflation. Number 7 was not broadly applicable because it was designed for those with very short time horizons and very little ability to tolerate any volatility.

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For the period 1992-2017, here is how they did assuming that each segment of the portfolio was invested in an appropriate passive vehicle:

PORTFOLIO

	1	2	3	4	5	6	7
Projected Real Return*	7.3%	6.7%	6%	5.6%	4.9%	4.1%	3.2%
Actual Real Return*	6.3%	6.2%	6.2%	5.9%	5.6%	4.8%	3.7%
Standard Deviation	13.4%	13.3%	11.8%	10.2%	7.9%	4.6%	3.5%

**Annualized total return net of inflation*

Since most people have a hard time thinking about standard deviation as a measure of risk, let's focus on the worst case calendar year return.

PORTFOLIO

	1	2	3	4	5	6	7
Expected Loss	23%	21%	18%	15%	12%	8%	7%
Actual Loss	30%	29%	26%	22%	16%	6%	.5%

Over the entire period, I think it is fair to say that these portfolios behaved pretty much as expected. But, that track record masks considerable variation from year to year. For example, there were a number of years when the conservative portfolios outperformed the more aggressive recommendations. While you would expect that it down years, it also occurred during some moderately positive years. There were also many years in which the order wasn't quite right; i.e. portfolio number 2 outperformed number 1.

But, taking the long view, the actual returns were fairly close to the projections, and the order was basically correct with the more aggressive portfolios generating the highest returns. Similarly, the more aggressive portfolios experienced the most volatility as measured by standard deviation of return. The one "miss" was the maximum losses. As expected, the more aggressive portfolios suffered the greatest losses. But, the losses for most of the portfolios were greater than expected. These loss forecasts were based on capturing what should happen 95% of the time which is a common statistical practice. In fact, the Global Financial Crisis in 2008 and 2009 was essentially a five hundred year flood that produced losses that would only be expected to occur a small fraction of 1% of the time. But, despite the low probability, the flood actually happened. As the great Yogi Berra said, "It's tough to make predictions, especially about the future."

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Confidence

So, what do I make of all of this? First, while we will never get it exactly right, disciplined methods of forecasting long term returns should get us in the ballpark. Once again, returns were all over the place for short periods, but markets have a strong tendency to revert to normal over time. Second, portfolio construction based on these forecasts and appropriate diversification works. During this twenty five year period, we experienced all manner of equity markets including the Tech Bubble of 1999-2000, the Global Financial Crisis, and a roaring bull market from 2009 through today. Annualized quarterly inflation ranged from negative 3% to +3%, ten year US Treasury interest rates fluctuated in a range of 1.5% to 7.5%, and both political parties enjoyed stretches in power. All in all, I would argue that this period represented a fair test of the investment principles on which my book and our firm were and are based. And, with all due modesty, I think we passed.

All of this is both timely and relevant because simple U.S. stock/bond portfolios have generated great returns with low volatility over the last nine years causing many people to question the benefit of diversification, hedges, volatility control, and all of the other features of the Endowment Model. Moreover, some people are extrapolating recent strong returns while our models indicated more modest single digit returns. We believe that diversification and risk control will matter again soon and argue that investors should have reasonable expectations given the starting valuation of virtually all capital markets. Hopefully, the data included herein lends credibility to these statements and provides comfort and confidence in the "steady as you go" approach to investing that we practice.

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