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It's Amazing How Well Dumb Things Work

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Summary

- Investors often make simple things complex.
- I'm constantly amazed at how well "dumb" rules work.
- If it's stupid, and it works, it's not stupid.

I am often amazed at how well dumb rules can work, across an *entire* bull and bear market cycle. Indeed, in any given year, a simple approach will tend to look dumb. However, across an entire bull and bear market cycle, a dumb approach can work rather well.

Rather than getting into complex futures-based approaches involving risk parity theories, etc, let's examine a simple, dumb, do-it-yourself approach.

Here are the rules:

I. Go long SPY (NYSEARCA:SPY), GLD (NYSEARCA:GLD), and TLT (NYSEARCA:TLT) with 33.33% dollar weightings for each.

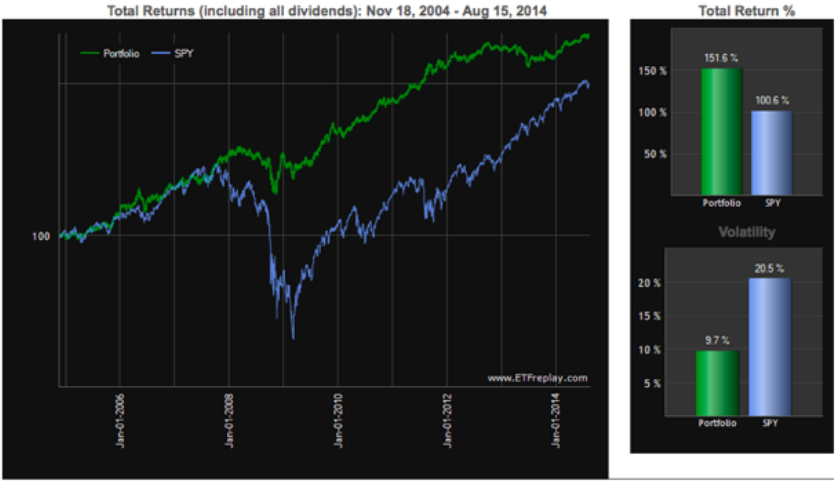
II. Rebalance annually to maintain the equal dollar weightings between the positions.

The logic is that SPY gives cheap stock market exposure. GLD gives monetary inflation exposure. TLT provides potential deflation exposure through long duration bonds, while handily moving inversely to stocks (on average, but not always).

In a stagflation in which both stocks and long duration government bonds drop, gold has a good chance of rising.

Here are the results in a log scale:

(click to enlarge)



Summary Statistics

	CAGR	Sharpe Ratio	SPY Correlation	Max Draw vs Start	Max Drawdown
Portfolio	+10.0%	0.78	+0.44	-1.75 %	-19.43 %
SPY	+7.4%	0.32		-37.72 %	-55.20 %

Annual Performance

	2004 *	2005	2006	2007	2008	2009	2010	2011	2012
Portfolio	+0.4%	+10.4%	+13.0%	+15.3%	+0.7%	+9.5%	+17.8%	+15.1%	+8.4%
SPY	+2.3%	+4.8%	+15.8%	+5.1%	-36.8%	+26.4%	+15.1%	+1.9%	+16.0%
+ / -	-1.8%	+5.6%	-2.8%	+10.2%	+37.5%	-16.8%	+2.7%	+13.2%	-7.6%

	2013	2014
Portfolio	-3.1%	+10.9%
SPY	+32.3%	+7.0%
+ / -	-35.4%	+3.9%

The approach has higher returns and lower drawdowns across an entire bull and bear market cycle than the S&P 500, along with a better Sharpe. The strategy's worst year is 2013, at -3.1%, which is probably enough to get most portfolio managers fired when the stock market has a 30%+ year (even though such an investor would have looked like a hero in 2008). However, a portfolio manager who employed this decidedly humble, simple approach, would actually have been doing well for clients as a fiduciary.

Personally, I choose to employ far more advanced approaches, but investors could have done far worse than this dumb approach. If it's stupid, and it works, it's not stupid.