



Cash, bonds, stocks, real estate, or gold

For more on this topic, go to www.dentaleconomics.com and search using the following key words: *Naught Decade, investment performance, Resampled Efficiency, Brian Hufford.*

Let's look at **INVESTMENT PERFORMANCE** over the past decade (the Naught Decade), and determine what **wisdom** can be gained for the future decade (the Tenth Decade).

The Naught Decade illustrated in grand fashion the first principle of investing: 70% of investment performance is determined by the broad asset classes represented in an investor's portfolio. If broad asset classes are represented by cash, bonds, stocks, real estate, and gold, then let me present principles for building a portfolio for the future.

For illustration, I have chosen Vanguard Funds (rather than indices). For cash, I have selected Vanguard Prime Money Market; for bonds, Vanguard Total Bond Market; for real estate, Vanguard REIT; and for gold, Vanguard Precious Metals. For stocks, I added four subasset classes: Vanguard Index 500, Vanguard Small Caps, Vanguard Developed Markets, and Vanguard Emerging Markets. This represents only eight mutual funds that nearly all investors could use. I selected Vanguard for illustration purposes only and not in an investment advisory capacity.

The Naught Decade was difficult for investing. For the decade, the Vanguard Index 500 Fund lost approximately 1.03% per year. For the eight-fund universe, five funds had returns of 6% per year or less. Two funds, real estate and precious metals, led the eight funds for each of eight years.

Strategy 1 – Buy what's hot

Everyone knows that gold is hot while real estate is not. In the Naught Decade, Vanguard Precious Metals rose by nearly 18% per year, taking the No. 1 spot for performance among the eight-fund universe. The wisdom in 1999 was to buy and forget the Vanguard Index 500 Fund, a top performer for the 1990s. For the Naught Decade, Vanguard Index 500 came in last. The Vanguard Precious Metals Fund lost 1.40% per year during the 1990s. This was perhaps the largest "bubble" decade in history, with bubbles in technology stocks, energy stocks, the economy, and real estate. Is gold the final bubble? What will lead the Tenth Decade?

Strategy 2 – Find the perfect investment strategy

My investment journey began with a simple task: purchase and hold the top performing asset class for each year. In this case, we are only using eight mutual funds. So, what would our performance have been for the Naught Decade if we

could have bought and held the top performing Vanguard Fund for each year from our eight funds?

The overall performance would have been 35.45% per year, just by taking the top performing Vanguard Fund from among the eight choices annually. How hard is this to do?

One approach to answering this question is to examine a large database of mutual funds to determine if any manager has found the Holy Grail. I have such a database. Of some 25,000 funds, only 8,200 have a 10-year track record. Among these, only 355 have a 10-year track record that exceeds 10% per year and represents about 4% of the fund selection database. From these 355, nearly all were objective-specific funds, such as gold or China. The top performing fund overall is a Russia-only fund. Instead of evidence of a perfect strategy, there is primarily evidence of being in the right place at the right time — something called luck.

Strategy 3 – Diversify and allocate scientifically

When an investor has life savings at stake, diversification is very important. One approach in diversifying a portfolio over the eight mutual fund universe listed is a process called Resampled Efficiency. Holding a U.S. patent and developed by New Frontier Advisors, LLC, this process aims to mathematically determine overall allocation based upon an investor's risk tolerance with investments in each asset class. As far as science goes, this is a sophisticated tool. Unfortunately, science can't predict the future. In that regard, economics is perhaps a pseudo-science.

I prepared three portfolios: high risk, middle risk, and lower risk using this methodology for the eight-fund universe. Here are the performances achieved: High Risk (7.13% annualized return for Naught Decade; 2009, +48.71%; 2008, -42.59%); Middle Risk (5.53% annualized return for Naught Decade; 2009, +23.61%; 2008, -22.94%); Lower Risk (5.34% annualized return for Naught Decade; 2009, +14.49%, 2008, -6.37%).

Investors are only compensated for risk and are rarely, if ever, compensated for luck over longer periods of time. **DE**

Disclosure: Past performance is not indicative of future performance or that losses won't occur. Performance has been taken from sources deemed reliable, but errors may exist. Hufford does not represent the material in this article as investment advice.

Brian Hufford, CPA, CFP®, is CEO of Hufford Financial Advisors, LLC, an independent, fee-only planning firm that helps dentists achieve financial peace of mind. Contact Hufford at (888) 470-3064, or bhufford@huffordfinancial.com.