By Alan Snyder

7%+ net, 6 mos. duration, no leverage, hard asset… STINKS.

Or does it? Our headline is a summary of investment stats for our Art Lending Fund portfolio. They serve as one benchmark for a conservative strategy that we like. Possibly, this could mean that there is no accounting for our taste. Let's see. We investigate how some investors actually performed historically for comparison and insight.

Spoiler alert, past investor results shocked us and may well shock you. The caveat of course, is that none of our readers are average performers.

DALBAR, Inc. is a leading analyzer of investor returns. In their "Quantitative Analysis of Investor Behavior" for the period ending December 31, 2017, they compared the average mutual fund investor to the relevant index.

20-Year Average Returns

Average Equity Fund Investor	S&P 500	Average Fixed Income Fund Investor	Bloomberg-Barclays Aggregate Treasury Index	Inflation
5.29%	7.20%	0.44%	4.60%	2.15%

The average equity investor underperformed the index and the average fixed income investor got walloped. Results in 2018 were worse. Over thirty years, the picture is even gloomier. The reasons are many:

1. Loss aversion
2. Narrow framing - inadequate diversification and jointness (click here to read "Jointness and Resilience")
3. Anchoring – lack of adaptation
4. Mental accounting versus true performance measurement
5. Herding – buy high/sell low
6. Regret – inaction when called for
7. Media bias
8. Optimism – reversions when met with reality

Numbers 1 and 5 are the primary drivers of the performance shortfalls.

Many will assert that the individual investor is dumb money - always wrong, uninformed, and subject to all of the influences detailed above. And it is the institutional investor with deep resources from advisors, consultants, staff and detailed unbiased quantitative analytics who is the model. Maybe… although our subjective experience over 40 years would indicate otherwise. (See *Barron's* "Stocks Keep Hitting Record Highs. Where to Find Values Now" for corroboration.)

A robust sampling of endowment funds drawn from *Pension and Investments* magazine is a wee bit more encouraging. Over 20 years, some of the top performing university endowments representing $99 billion in assets averaged over 8%. However, given their long investment horizon, they are able to invest in private equity, venture capital, and even timberland, all of which have very limited liquidity and are long duration.

Dennis Hammond, a noted institutional consultant, analyzed the performance of endowments undertaken by the National Association of College and University Business Officers ("NACUBO") with greater granularity in the table below:

Periods ending FY2018	**Large (%)**	**Avg (%)**	**Median (%)**	**Small (%)**	**60% Equity/40% Debt**
Last Year	9.7	8.2	8.0	7.6	8.3
Last 3 Years	6.8	6.2	6.1	6.2	7.9
Last 5 Years	8.2	7.3	7.2	7.5	9.0
Last 10 Years	6.0	5.8	5.7	5.8	7.8
Last 20 Years	7.7	6.1	6.0	5.3	6.0
Last 30 Years	9.9	8.4	8.3	7.6	8.9
Last 40 Years	11.2	9.7	9.6	8.7	10.3
Last 50 Years	9.6	8.5	n/a	7.8	9.0
Last 57 Years	n/a	7.9	n/a	n/a	8.6

Source: NACUBO Performance Studies from 1971 to 2018

In the last column, "60%/40%," he compares their performance to that famous equity and debt mix for each of the same time periods. The comparison is not pretty, notwithstanding all of the expert advice.

A cohort of pension plans with $741 billion in assets did not do as well, averaging approximately 6%. This group generally has greater liquidity needs than endowments meaning less opportunity to carry any illiquidity premium. In both cases, the portfolios are a blend of equities, debt, hedge funds, etc., so should do better than our average mutual fund investor.

Last, but not least, are hedge funds. At a recent conference, there was a panel of institutional investors discussing their criteria for selecting hedge funds. Two out of four indicated that the minimum for consideration was a double-digit return, whereupon the fellow next to me snorted and whispered to me that he knew both players and that they were lucky to print 5% returns on their portfolios, not double digits or even high-single after their fees. My cynical seatmate was well aware of the average numbers shown below:

	HFRI Fund Weighted Composite Index Return[1]	HFRI Fund of Funds Composite Index Return[2]
Last 5 years	3.9%	1.7%
Last 10 years	4.6%	2.4%
Last 20 years	6.1%	n/a
Since 2000 (19 years 9 months)	5.4%	3.2%
Since Inception	9.6% (Jan 1990)	3.2% (Jan 2000)

Over the longest term, the results are good, albeit less so for more recent periods. Hedge funds have proliferated, become even harder to distinguish one from another, and interestingly, more hedged in general as both bonds and equity markets have soared. Fund of funds, while underperforming, have approximately equaled average mutual fund investor results of a 60% equity/40% bond portfolio with less volatility (only seen in the more granular data).

How Much Risk?

For each of our investor types, how much risk is really acceptable given differing time horizons and current cash needs? Putting the pickle on the fork is Edward McQuarrie, an emeritus professor of business at Santa Clara University. Adjusting for inflation and reinvesting dividends, if even possible, across a diversified equity portfolio, the 1929 high would not have been reclaimed until 1936 or sustained until 1949. Staying fully invested sounds great and is preferred to maximize return, yet for most with limited timeframes and disbursement requirements, a portfolio with resilience and jointness may be a better solution. In short, the diversification mix required may necessarily be considerably different.

All of us recognize that compound interest is powerful but demands consistency. Circling back to our headline, doesn't a relatively high-yield investment with a short duration, low correlation, no leverage and collateralized by hard assets with modest loan-to-value ratios of less than 50% have a logical home in a portfolio when compared to the investment results shown earlier?

Don't spare us. Comments are most welcome. With luck, we hope our readers will not compare us to Andrew Lang, the Scottish poet and critic who wryly noted: "He uses statistics as a drunken man uses lamp-posts… for support rather than illumination."

[1] The HFRI (Hedge Fund Research Inc.) Fund Weighted Composite Index is a global, equal-weighted index of over 2,200 single-manager funds that report to the HFR Database. Constituent funds must have a minimum of $50 million under management or 12 months of active trading. The HFRI Fund Weighted Composite Index does not include funds of funds.

[2] The HFRI Fund of Funds: Composite Index is a global, equal-weighted index of over 500 fund of funds that report to the HFR Database. Constituent funds must have a minimum of $50 million under management or 12 months of active trading.