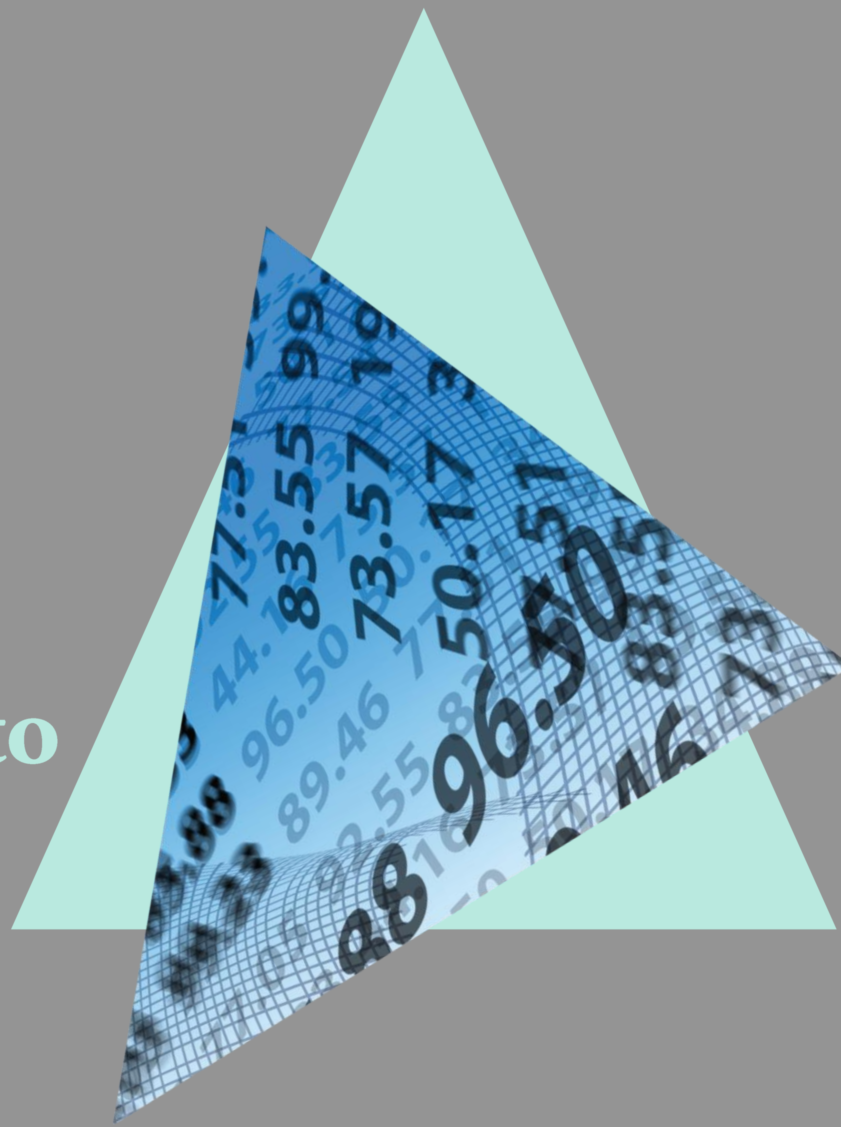
ALLODIUM
INVESTMENT CONSULTANTS

# The Science of Investing:
# How to Invest *Without* Needing to Pick Winners



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# Allodium Speakers

**David Bromelkamp, AIF®**

*President & CEO*

**Eric Hutchens, CFP®, AIF®**

*Senior Investment Consultant & Chief Investment Officer*

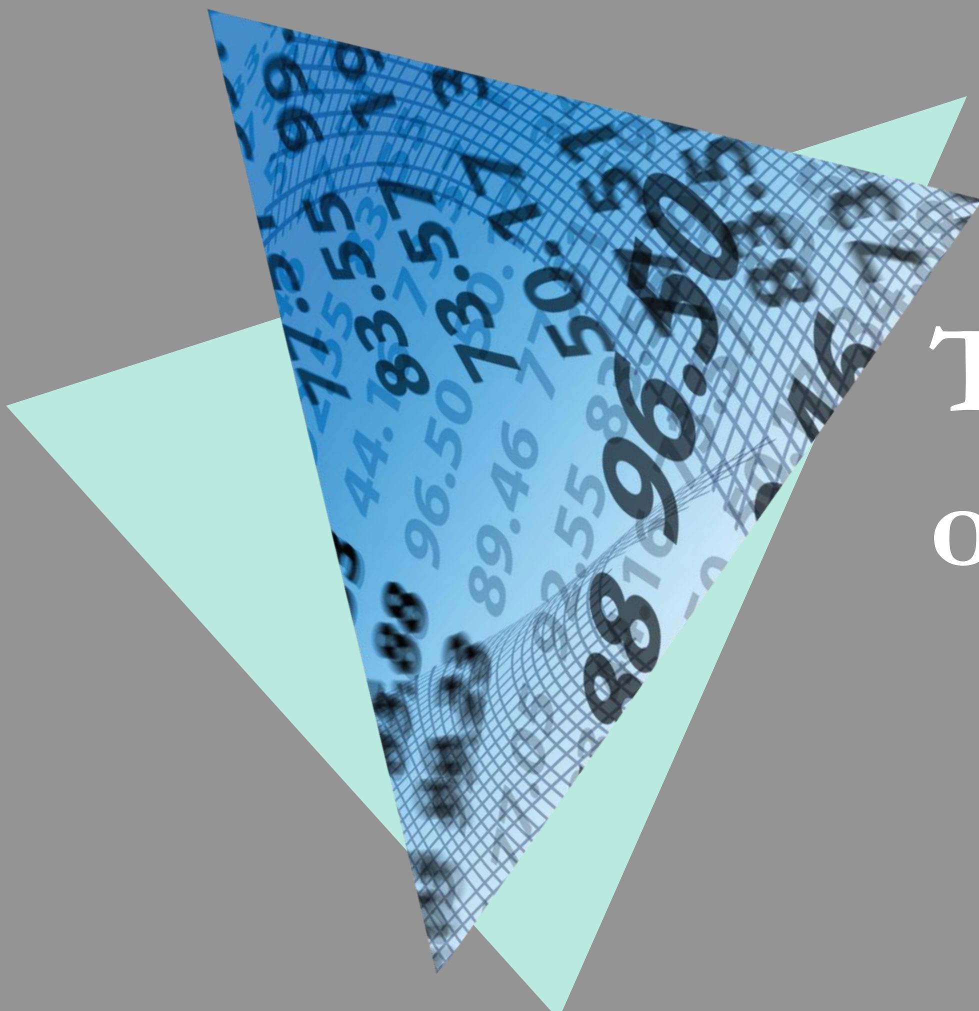
**Derek Van Calligan, CFP®, AIF®**

*Investment Consultant & Responsible Investing Specialist*

**Suzanne Tudor, AIF®, JD**

*Senior Investment Consultant & Director of Financial Planning*

# Introduction



# The Science of Investing

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## Introduction

# Time Budget for Today's Presentation

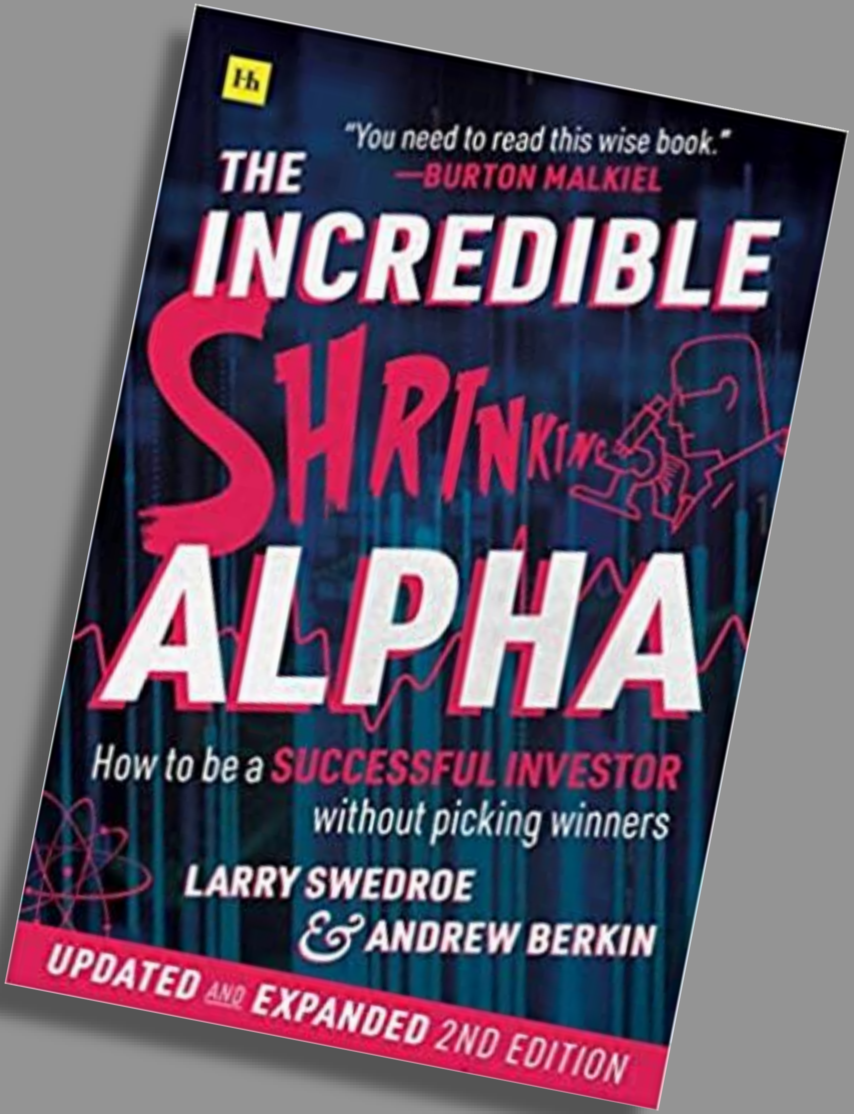
# Introduction

David Bromelkamp and Peter Lynch at the BEEF Luncheon at the Radisson Hotel South, Bloomington, Minnesota on Friday, May 14, 1993

# Introduction

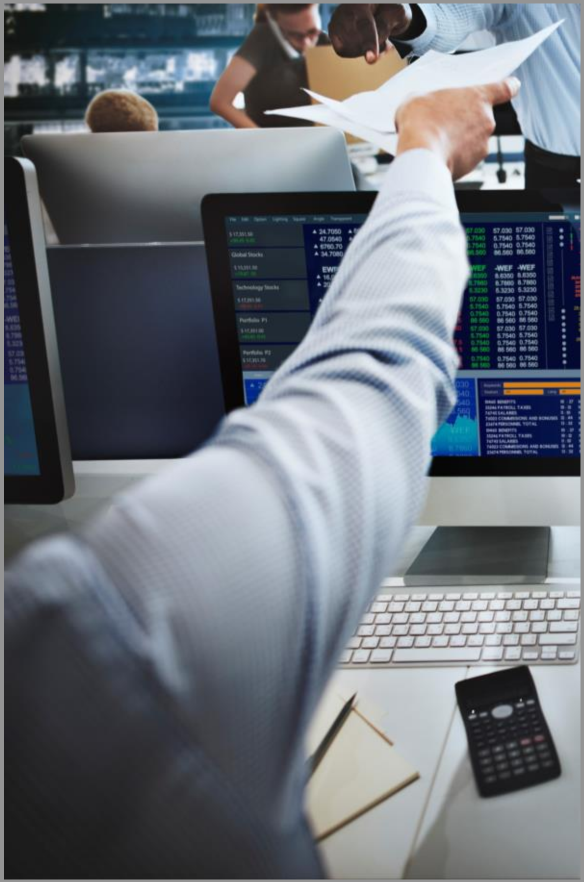
Source: Regis Media@Regis Media (9.18.2018)

Larry Swedroe



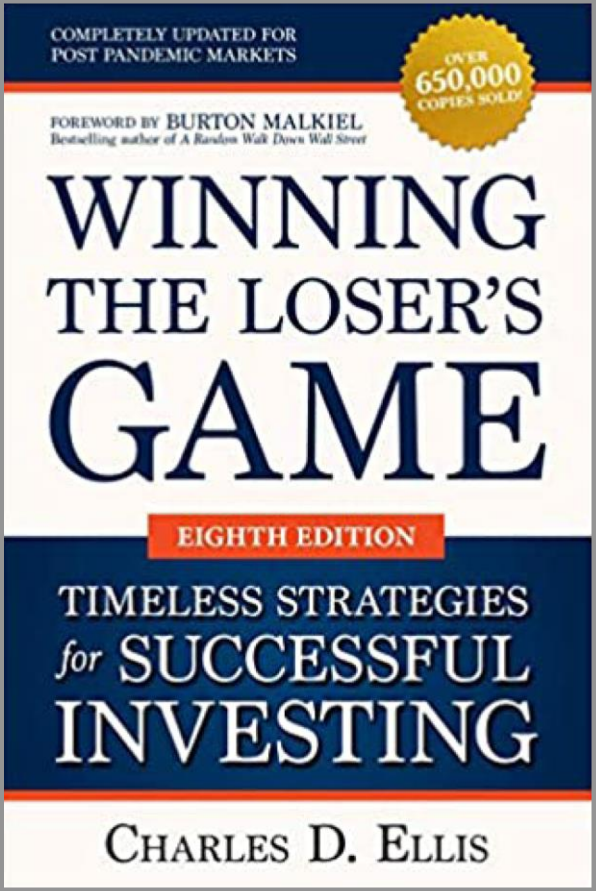
# Introduction

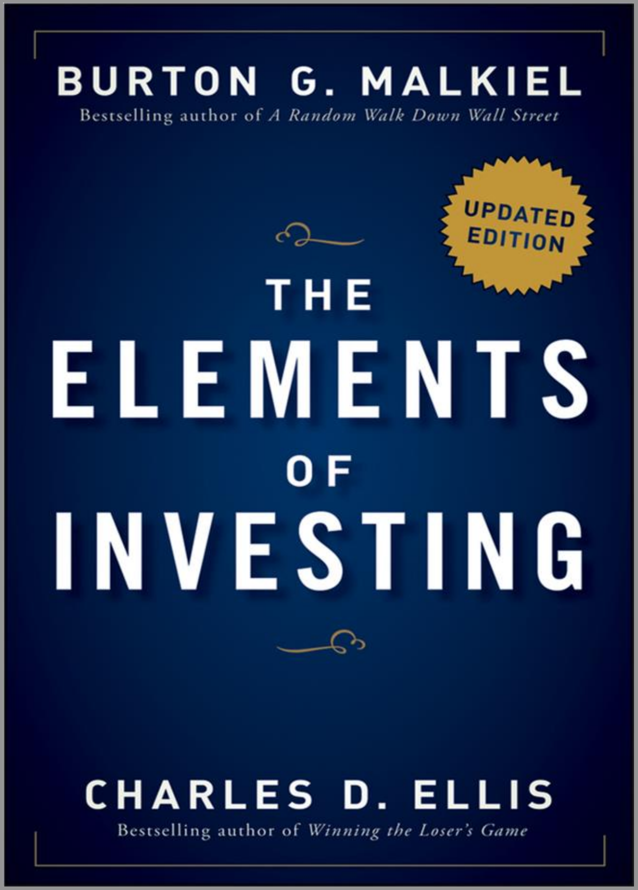
## Active vs. Passive

# Introduction

## Active vs. Passive



# Introduction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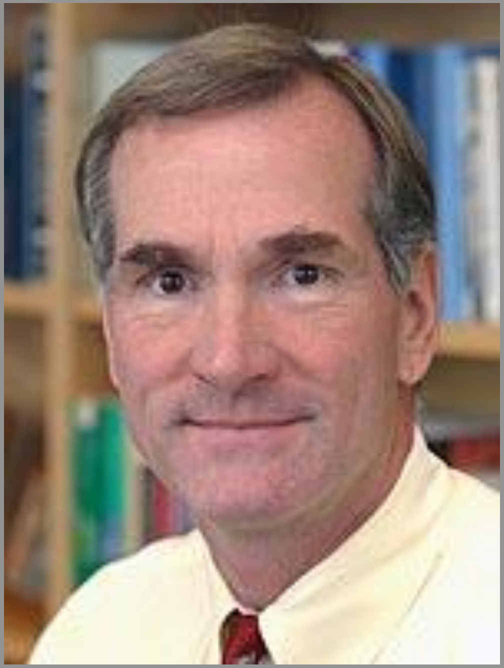
# Introduction

# Introduction

## Yale University



Source: Amazon

David Swenson

# The Holy Grail

Let's start with some definitions…

"Alpha"
Additional risk-adjusted returns above a benchmark

"Beta"
Risk of an asset compared to the overall market

# The Holy Grail

# The Holy Grail

## The Capital Asset Pricing Model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# The Holy Grail

## Fama-French Three Factor Model



Eugene Fama

1. Beta: Stocks outperform risk-free assets (one month T-Bills)

# The Holy Grail

## Fama-French Three Factor Model

Source: Bengt Nyman from Vaxholm, Sweden, CC BY 2.0 via Wikimedia Commons

Eugene Fama

1. Beta: Stocks outperform risk-free assets (one month T-Bills)
2. Size: Small company stocks outperformed large company stocks

# The Holy Grail

## Fama-French Three Factor Model

Source: Bengt Nyman from Vaxholm, Sweden, CC BY 2.0 via Wikimedia Commons

Eugene Fama

1. Beta: Stocks outperform risk-free assets (one month T-Bills)
2. Size: Small company stocks outperformed large company stocks
3. Value: Value (“cheap”) stocks outperformed Growth (“expensive”) stocks

# The Holy Grail

## Explaining Warren Buffett's Alpha

Source: USA International Trade Administration, Public domain, via Wikimedia Commons

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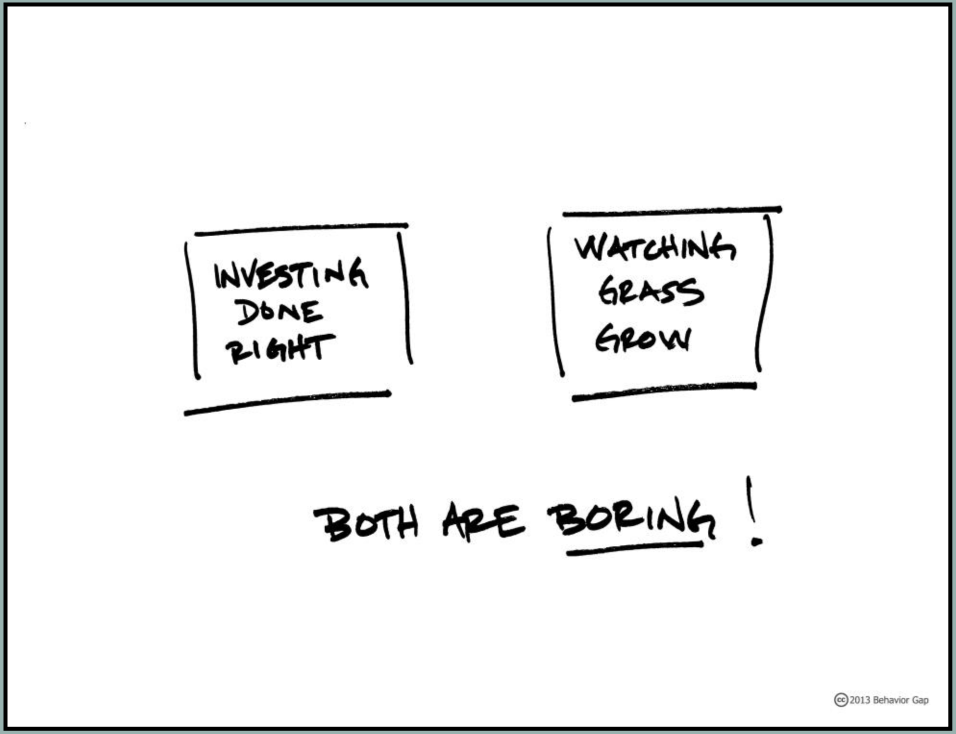
# The Pool of Victims is Shrinking

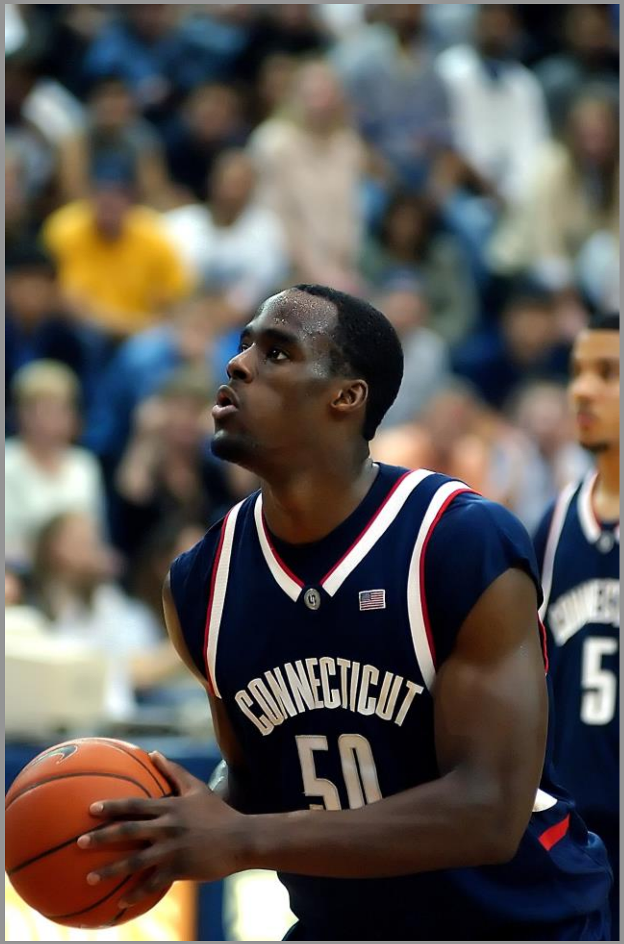
# The Pool of Victims is Shrinking

1. Less active / more passive
2. Greater competition for a smaller pie
3. Good news for passive and evidence-based investors



# The Competition is Getting Tougher

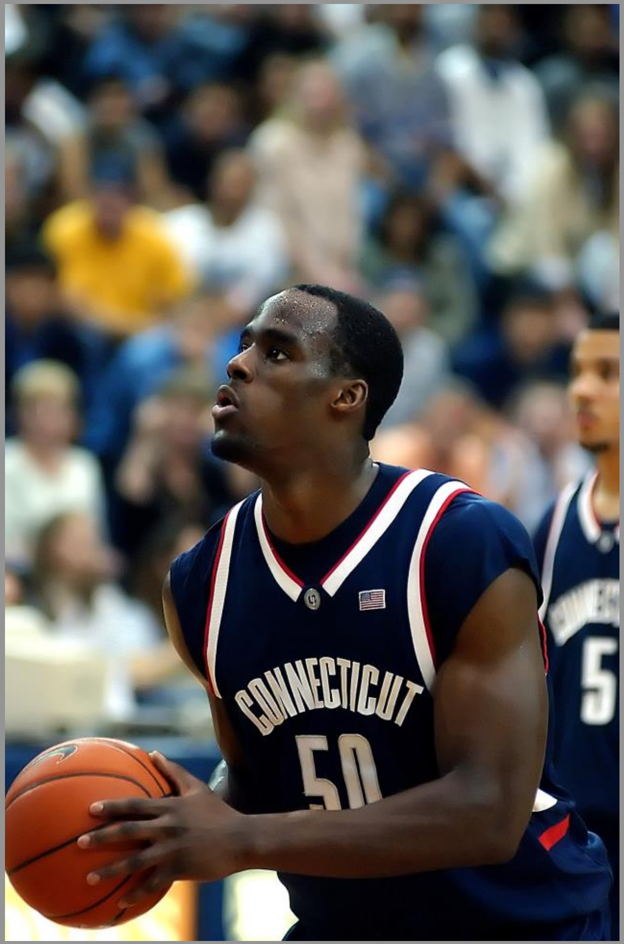
1. Best player shoots 90%
2. Average player shoots 73%
3. You shoot 83%



# The Competition is Getting Tougher

1. Best player shoots 90%
2. Average player shoots 73%
3. You shoot 83%

*Should you participate or take the average of those that do?*



# The Competition is Getting Tougher

## The Paradox of Skill

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# Is the Market for Alpha Overgrazed?

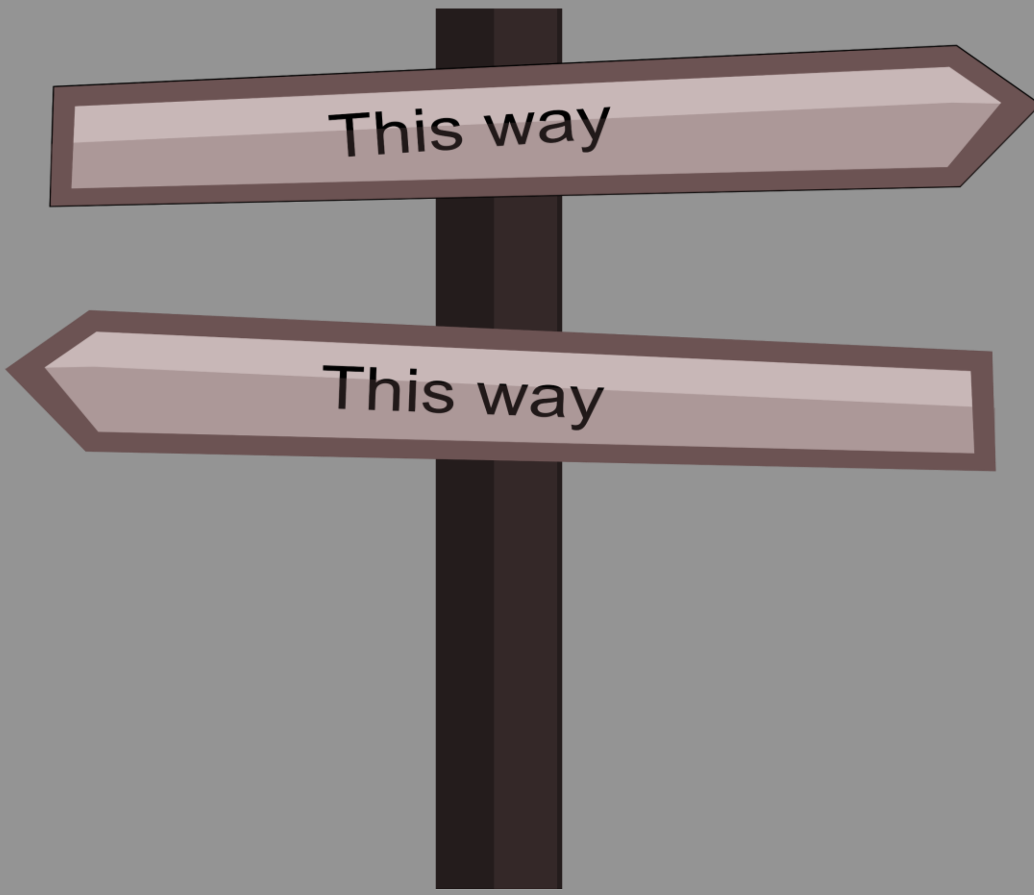
Bubbles created due to over-crowding:

- Tech bubble of 2000
- Residential real estate bubble of 2008
- "Tronics" bubble of the 1960s

# Is the Market for Alpha Overgrazed?

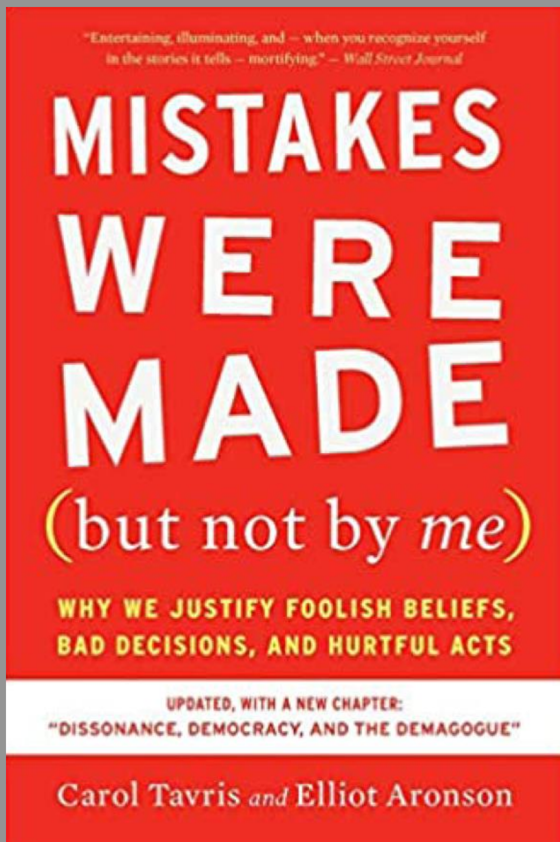
- 25 years ago, there was approximately $300 billion invested in hedge funds
- In 2020, there is over $3 trillion invested in hedge funds

# Why Do Investors Ignore the Evidence?




50% of investors continue to favor actively managed strategies

# Why Do Investors Ignore the Evidence?




*"Most people, when directly confronted with proof that they are wrong, don't change their point of view or course of action but justify it even more tenaciously."*

—Carol Tavris and Elliot Aronson

# What You Can Do

## Play the winner's game!

Focus on the ***five critical things*** you can control.

# What You Can Do

1. Decide what risks to take, and how much of them

# What You Can Do

2. Diversify your risks

# What You Can Do

3. Invest in systematically managed funds


4. Keep your costs low

# Stay Disciplined

*"Success in investing doesn't correlate with IQ. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people in trouble investing."*

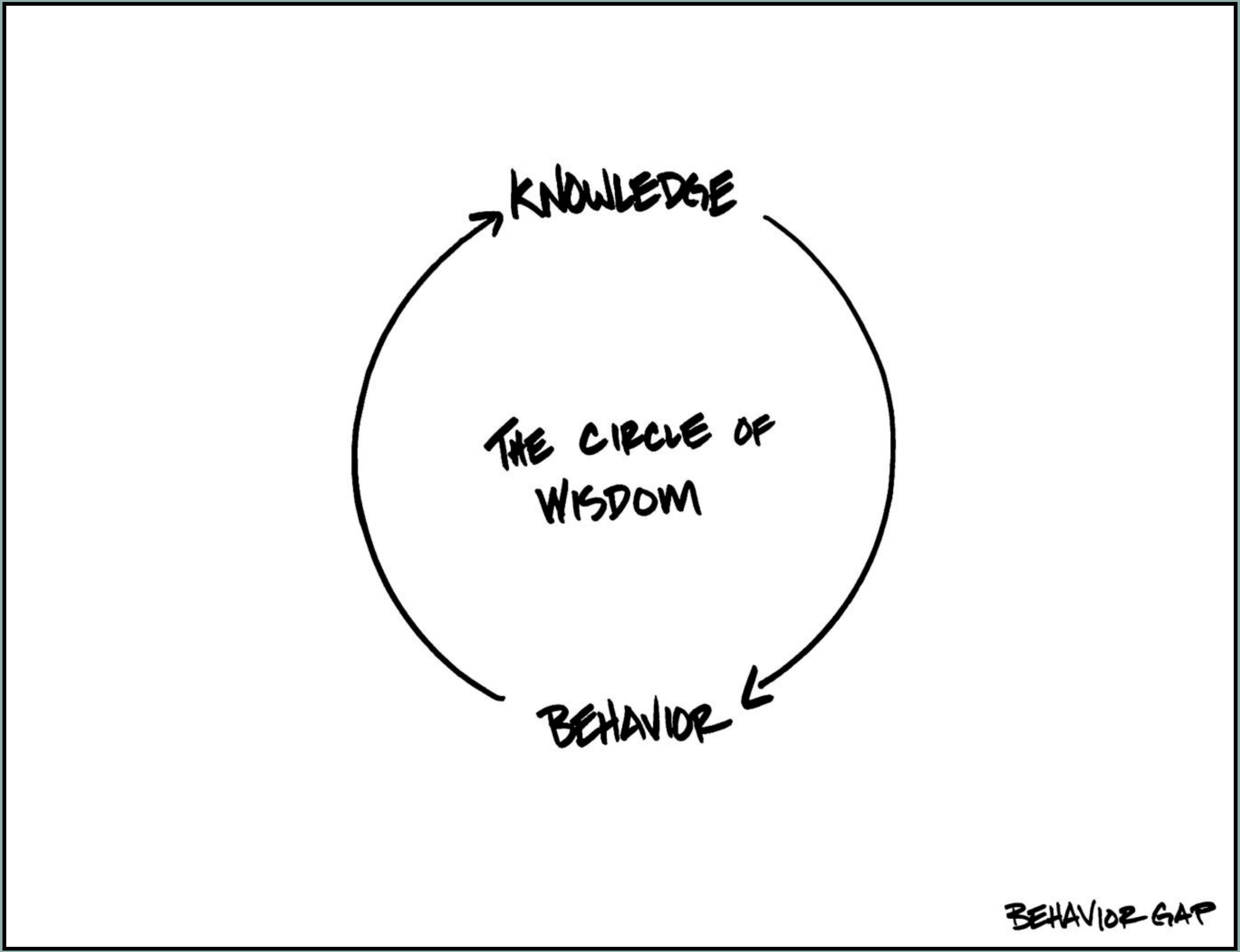
—Warren Buffett, Business Week, June 25, 1999

# Stay Disciplined

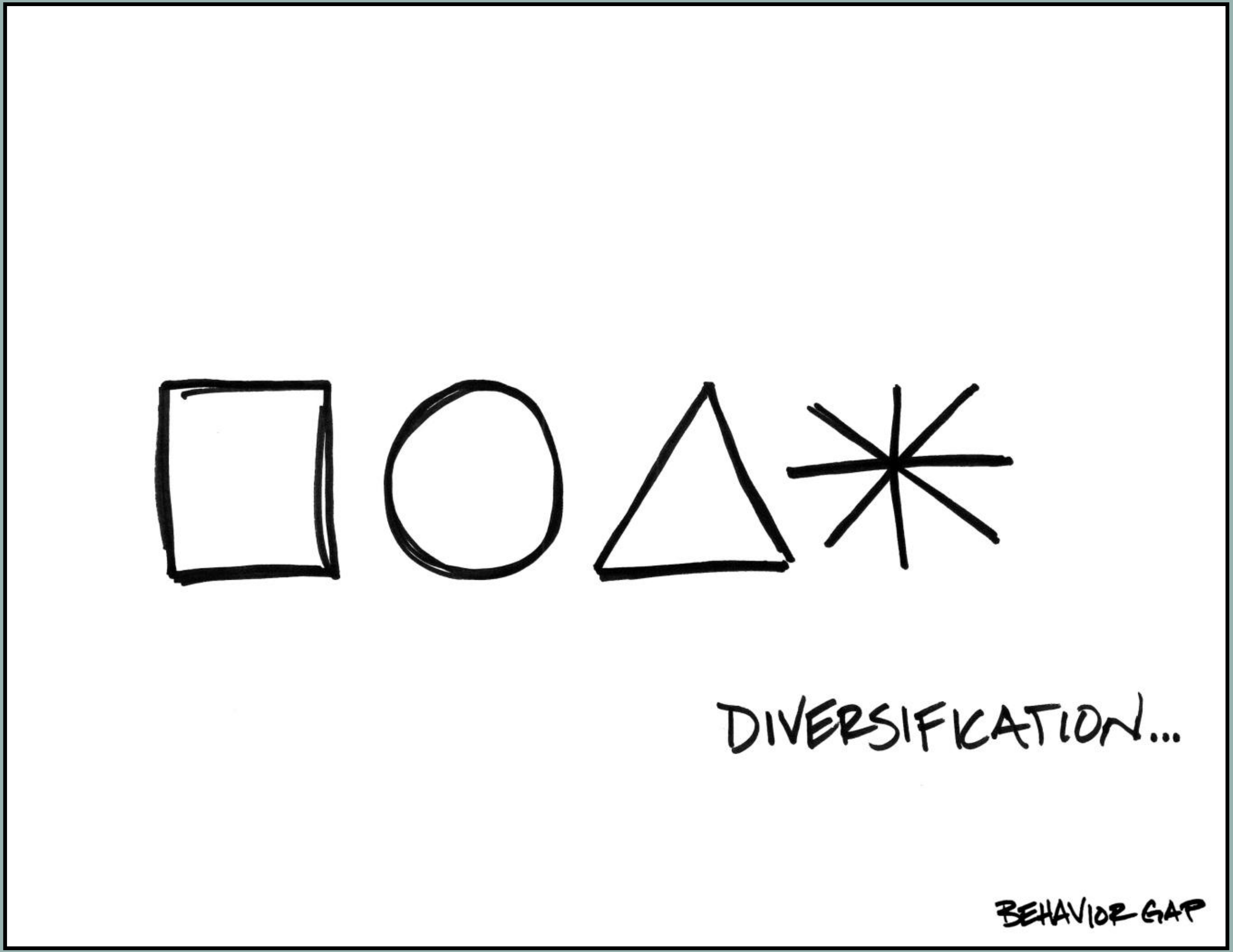
*"One of the most common mistakes investors make, and one that can cause the most damage, is that when it comes to evaluating investments and investment strategies most think that three years is a long time, five years a very long time, and 10 years an eternity. In fact, financial economists know that 10 years can be nothing more than noise."*

—Larry Swedroe

# Stay Disciplined



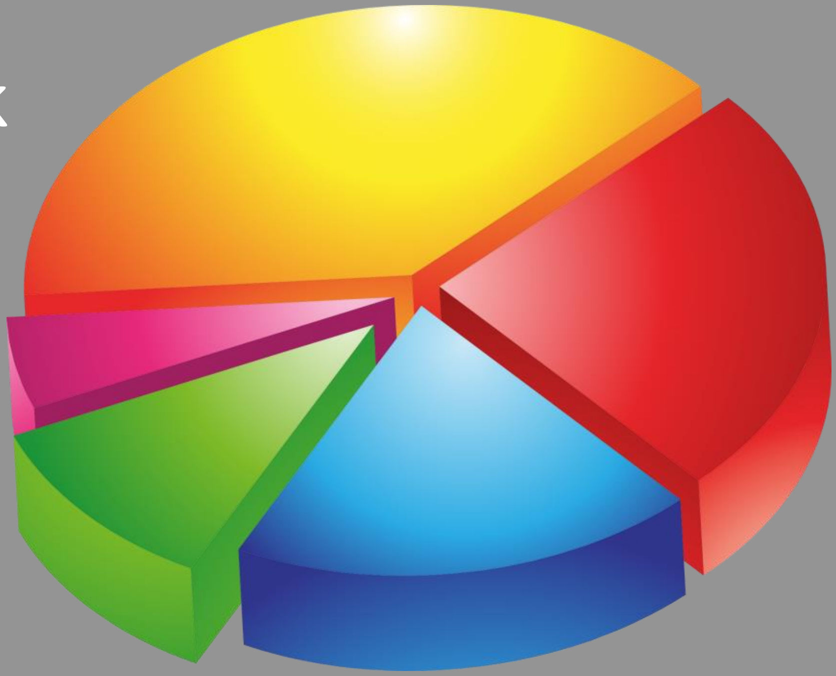
# Stay Disciplined



# Asset Allocation

## Each Individual's Three Tests:

1. Ability to take risk
2. Willingness to take risk
3. Need to take risk



# Asset Allocation

## The Ability To Take Risk

An investor's *ability* to take risk is determined by four factors:

1. Investment horizon

# Asset Allocation

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2. Stability of earned income

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# Asset Allocation

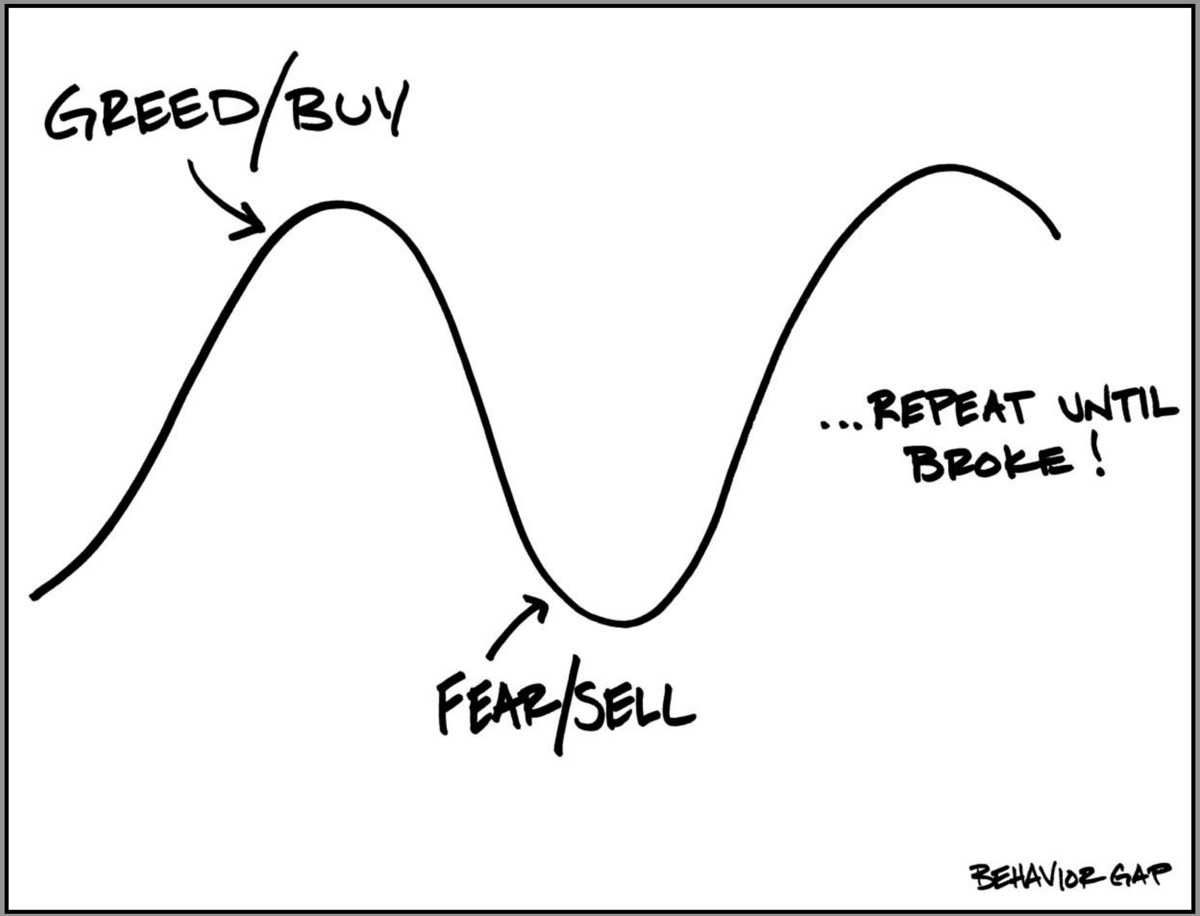
## The Ability To Take Risk

An investor's *ability* to take risk is determined by four factors:

1. Investment horizon
2. Stability of earned income
3. Need for liquidity
4. Options if a "Plan B" is needed

# Asset Allocation

## The Willingness to Take Risk



# Asset Allocation

## The Need To Take Risk

- Needs vs. desires
- The "marginal utility of wealth"

# Asset Allocation

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# Asset Allocation

## Asset Allocation Decisions

1. Equities vs. Fixed Income

# Asset Allocation

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1. Equities vs. Fixed Income
2. U.S. vs. International/Emerging Market

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1. Equities vs. Fixed Income
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3. Large-cap vs. Small-cap

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4. Factors (such as Value vs. Growth)

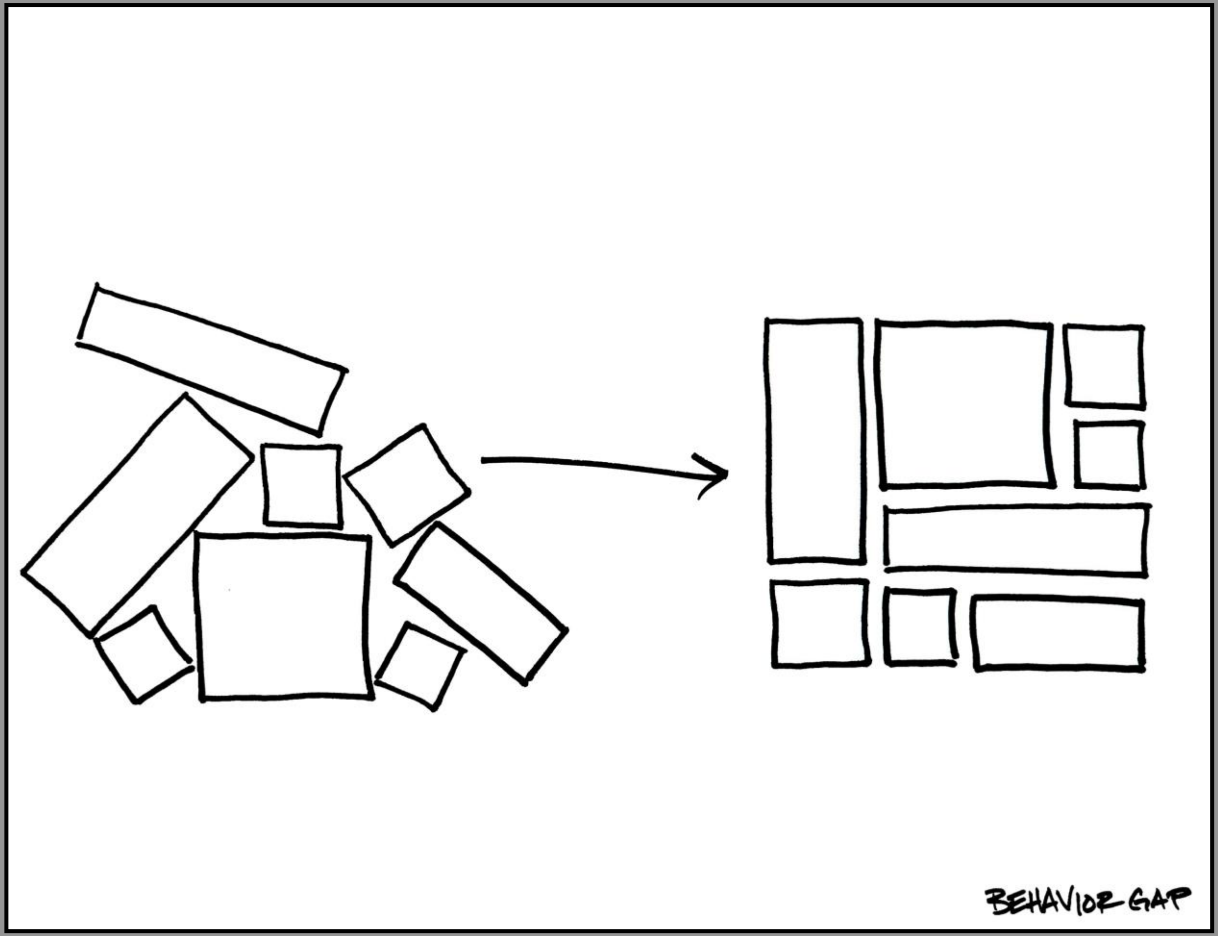
# Asset Allocation

## Asset Allocation Decisions

1. Equities vs. Fixed Income
2. U.S. vs. International/Emerging Market
3. Large-cap vs. Small-cap
4. Factors (such as Value vs. Growth)
5. Use of other asset classes (alternatives)

# Asset Allocation

## Implementation



# Asset Allocation

## Care and Maintenance of a Portfolio

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# Summary

1. The Science of Investing
2. Active versus Passive
3. The Holy Grail = Manager Alpha
4. Pool of Victims, Competition, Overgrazed
5. Ignoring the Evidence?
6. What You Can Do
7. Asset Allocation

# Thank you!

# Q&A

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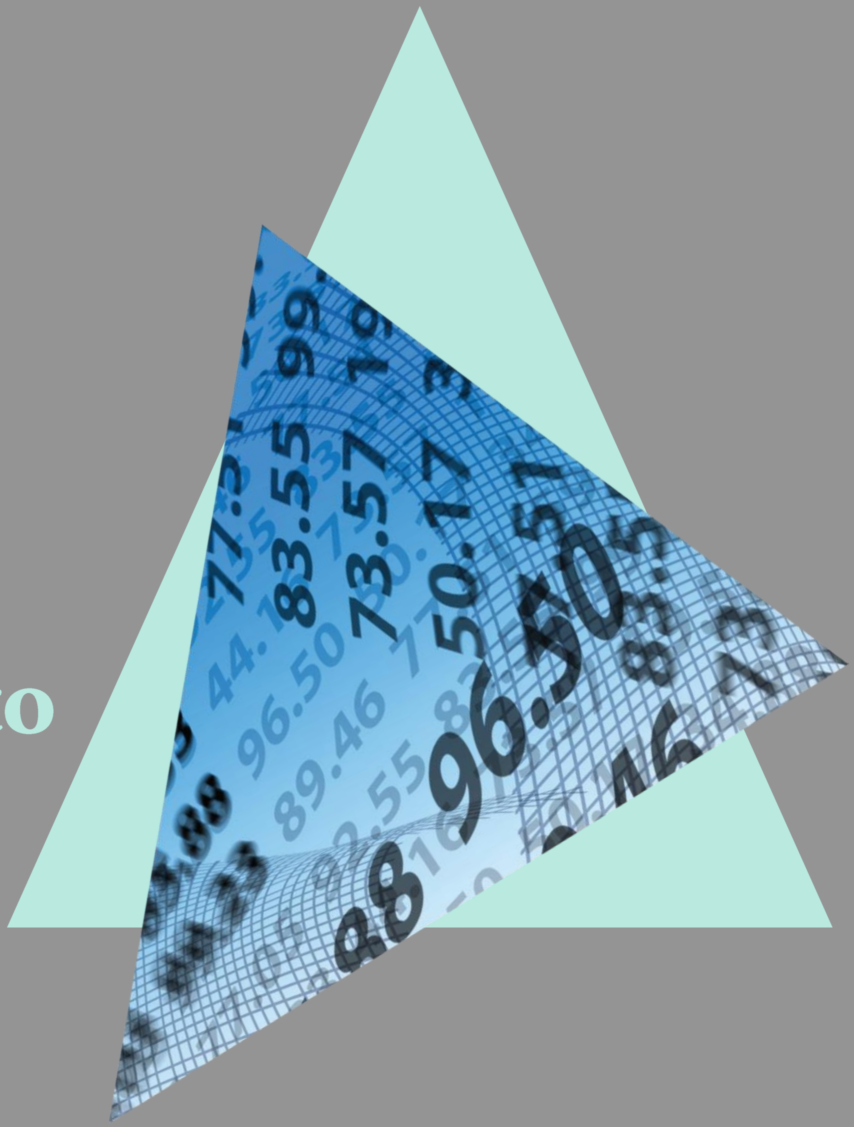

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