



## Portfolio strategy: Ken Fisher

Forbe's Magazine's Portfolio Strategy columnist and Fisher Investments chief executive KEN FISHER reveals a few tactics that could help put your portfolio back on the right track and explains why it's not always a good thing to be overweight

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# Why risk is a weighty matter indeed

**R**ecently I've lost a ton of weight. Why? And what has that got to do with portfolio strategy? Lots. I never worried about weight. In my family, everyone lives into their 90s, so I presumed I would. When a friend my age died of a heart attack, it shocked me into applying a key portfolio management rule into my personal life: always know you could be wrong.

This is as basic a portfolio strategy rule as exists. The analogy carries farther than you may imagine. Think of someone retired in 2000 who essentially became a technology-only investor. Today, their portfolio is decimated and this has impacted their basic retirement lifestyle. The mistake? Not recognising the need to build a portfolio that accommodates bets but comes out OK when you're wrong. So how to do that? Blend negative correlations that protect – much like casualty insurance does. For example, technology and drug stocks have similar long-term returns but are usually short-term negatively correlated – meaning in a given month, if one rises, the other usually falls.

If in 2000, for every pound of tech our investor bought, he had bought 80% as much drugs, then if his bullish bet on technology ended up being right, he would have beaten most investors. But since it didn't, instead of getting wiped out, as his friends did, his drug stocks would have protected him and he would have only lagged the market by a little.

Back to weight – it's a lot like genetics. Suppose you were in the US managing



against the US stockmarket in general and the S&P 500 in particular. In January, 2000, technology was 30% of the S&P and US markets. For someone bullish enough to be 50% technology (an overweight to tech by two-thirds), the past 30 months have been brutal, absolutely and relatively. But not nearly as bad as that 50% weight was for a UK investor managing against UK stocks in general and, say, the FTSE All-Share, in particular.

Why? Because technology was only 5.4% of the broad UK market and a 50% tech bet was a 10:1 overweight, and while the absolute loss would have been similar to our American investor, the relative decimation to benchmark was vastly worse.

Managing weight and controlling risk are similar. Controlling risk lets you make very defined bets. If someone wished to bet on technology, without betting on the overall market, you might buy the Nasdaq 100 exchange traded fund (ETF), while selling short the Fointsie 100. That does it. Whether the overall market rose or fell would mean

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nothing to you. All that would matter would be whether tech beat or lagged overall bigger cap UK stocks. Instead, suppose you wished to make a "synthetic" bet on US small cap value stocks, the US sector that was hottest in 2001 and so far this year. Synthetic means doing so without buying single stocks but by isolating the desired effect within combinations of liquid indices or other non-stock securities.

We could do it by buying the Russell 2000 US small cap ETF (symbol IWM) while selling short the same sterling amount of Nasdaq 100 (symbol QQQ). When selling short, you inject into your portfolio the exact reverse features possessed by that thing you're shorting. Since the dollar weighted capitalisation of the QQQ is much bigger than that of the IWM (and shockingly, in fact, bigger than the S&P 500 or the FTSE 100), when you sell it short, you reduce your portfolio's overall average market capitalisation.

Since the QQQ is growth-oriented, and the Russell 2000 has average valuations, when you sell short the QQQ and buy the Russell, you add "value-ness" to your portfolio, too, creating true US small cap value. In any month or quarter in 2001 or 2002, this combination would have generated a return after transaction costs close to typical small value mutual funds or indices (which require picking, are illiquid and hard to trade).

Having great respect for portfolio theory, I've blended risks well in portfolios for many years. Ironically, I haven't done that in my personal life. I hope I've learned the lesson. I hope you have too.