

The Challenges of Standard Portfolio Diversification

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Last week on my podcast, I had the opportunity to interview Vinay Nair, a Wharton professor and co-founder of the firm 55 Capital Partners. Nair's research sits at the intersection of macroeconomic and corporate fundamental factors and how they tie into capital market prices. Tying his academic research—investing science—in with investment solutions and that work has led him to found 55 Capital.

The genesis of 55 Capital included some of the original founders of the exchange-traded fund (ETF) industry. Lee Kranefuss, who was the original iShares leader when it was part of Barclays Global Investors, linked up with Nair to solve a central problem: there is a large and growing list of ETFs to pick from today, and it is a challenge for investors and advisory firms to sort through and assemble diversified portfolios in unique ways. Bruce Lavine, WisdomTree's former President and current member of the WisdomTree Board of Directors, joined the firm to lead its Advisory business.

55 Capital sits at the intersection of active and passive portfolio approaches. Instead of choosing individual stocks and bonds, they are actively rotating between ETF building blocks for their portfolios.

Current Environment: Reflationary Risks Mean Standard 60/40 Portfolios Are Not Sufficient

Turning our discussion to the current market environment, Nair believes—for the first time in many years—that the market environment is calling for greater attention to the implications of reflation rather than fears stemming from narratives of deflation.

To Nair, reflationary risk means the standard equity/bond mix is no longer sufficient. It has been many years since both equities and bonds have declined at the same time, and investors have been able to count on the bond part of their portfolio to cushion declines in equity markets.

But Nair believes this may not be the case any longer in a world dominated by reflationary concerns—and he points to periods during the 1960s and 1970s when bonds declined by 40%–50% as a reminder that this type of scenario has happened before.

Nair argues that demographics demand a focus on investor withdrawals and drawdowns of their capital and that getting the maximum diversification possible is of prime importance in today's world—which is what 55 Capital strives to do with its portfolios.

Some other highlights of our conversation included themes like:

- Commodities and how to get exposure to them through equity investments in such countries as Australia and the emerging markets of Brazil and Russia.
- Why 55 Capital focuses on forecasting risk, not return, and how that can lead to better experiences
- Risks in the current market today, what is priced in and what isn't:
 - European political risk seems to Nair to be overly focused on and overestimated because of Brexit and Trump
 - China debt risk: Nair believes this is flying under the radar

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Important Risks Related to this Article

Diversification does not eliminate the risk of experiencing investment losses.

Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty.