

## Strategic Insight: Winter 2015-2016

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### Pretty Muted Last Three Years, If You Ask Me

Diversification reduces risk, a widely known fact. But few agree on exactly how to diversify across investment types to achieve the promised low-risk land. We think that a basket of U.S. and foreign stocks, U.S. and foreign bonds and a small slice of commodities offer excellent diversification year after year. However, there are years in which one group dominates the pack, leaving us to wonder why we could not have seen the outperformance coming. For example, U.S. stocks have dominated the investment world since 2008, though emerging markets shared the stage until the commodity collapse in 2011. But those of us with long memories remember the period 2000 through 2008 when foreign and emerging markets were dominant. The diversified model has the advantage of offering excellent risk-adjusted returns year after year, though one or more of its components may have soared or crashed. This is diversification in action.

Our Moderate [risk] Benchmark Portfolio's stock and bond allocations by company domicile are 65% U.S. and 35% foreign, including emerging markets. If we were to allocate strictly according to market composition, our U.S. component would be 50% in a stock allocation and U.S. bonds would be 48% in a bond allocation.

The table below shows the returns for 2013-2015 from our Moderate Benchmark Portfolio. The portfolio gained 5.3% a year over the three years, helped greatly by outsized gains in 2013. Did your accounts fare about the same? No, because we over-weighted the U.S. to about 75% and held no commodities. Most of us gained from 8% to about 12% in our accounts over the last three years.

Moderate Benchmark Portfolio Returns 2013-2015						
Ticker	Proportion of Portfolio	Investment Type	2015 Total Return	2014 Total Return	2013 Total Return	Annual 3 Year Return
<b>Stocks</b>						
ITOT	36%	US Total Stock Market	0.9%	13.0%	32.7%	14.8%
VXUS	19%	International Total Stock Market	-4.2%	-4.7%	14.6%	1.5%
<b>Bonds</b>						
LQD	21%	US Quality Bond	-1.3%	8.2%	-2.0%	1.6%
JNK	5%	US High Yield Bond	-6.8%	0.8%	5.9%	-0.2%
BNDX/PFBDX*	14%	Foreign Total Bond	1.2%	8.7%	-0.2%	3.2%
<b>Commodities</b>						
DBC	5%	Commodities (Metals, Energy, Minerals)	-27.6%	-28.1%	-7.6%	-21.7%
<b>Portfolio Returns</b>			<b>-2.3%</b>	<b>5.3%</b>	<b>14.0%</b>	<b>5.3%</b>

\*BNDX/PFBDX combination; 2014-2015 returns are BDNX, 2013 returns are PFBDX

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