

Why doesn't BlackRock offer TAA?

If TAA is so good, then why doesn't everyone offer it?

First off, BlackRock, Nationwide, Invesco, and Fidelity all offer TAA products. Nevertheless, the investment industry widely appreciates that TAA is not commercially viable, i.e., it won't sell well. How do we understand this seeming contradiction? As we explore this question, keep in mind the distinction between a product selling well in a commercial setting . . . and that same product being the best possible investment solution for an individual investor. The two have little if any overlap. Let's begin.

To address this question in a substantive fashion, we must examine a specific example, one that anyone could replicate with ease and simplicity. We'll call our specific example the thought-experiment portfolio. It's a passive portfolio built from the 31 asset categories shown in the graphic below using these weights: 33.0% US stocks, 39.4% international stocks, 8.9% US Treasury bonds, 4.2% US investment grade corporate bonds, 1.6% international bonds, 2.1% gold, and 10.8% other commodities. Over the last 102 years (ending 1/31/2021) this portfolio would have delivered 14.5% per annum. That's pretty good.

But there's a bit more to the portfolio's construction. Since it's a TAA portfolio, it overweights recent winners and underweights recent losers - that's what TAA does. Specifically, it reconstitutes itself once each month, selecting the seven asset categories (drawn from the 31 shown below) that trended most strongly over that last eleven months (with a slight bias against last month's winners). These seven are then equal-weighted. This portfolio construction technique is the very essence of quite literally all TAA portfolios.



Failure to launch

The average annual return of 14.5% would seem to suggest a robust basis for stellar commercial success. But it's not. No investor can wait 102 years. Instead, there are two impediments to commercial success: (1) the short-term and (2) the occurrence of episodic eras. Let's consider each in turn.

The short-term - in a sales setting, buyers of investment products have an unrelenting tendency to compare to the S&P 500. Worse, yet, they make this comparison over short time periods. The dysfunction of this behavior is the topic for another day. For the moment, let's just accept it as an unfortunate aspect of consumer behavior. So how does the thought-experiment portfolio perform relative to the S&P 500, in the short-run? The answer is:

Investment time period	Probability (likelihood) of outperforming the S&P 500 Index
1 month	54%
3 months	52%
6 months	51%
1 year	54%
3 years	63%
5 years	68%
7 years	70%
7.5 years	71%

From a sales standpoint, from a commercial perspective, this is pretty bad. If beating the S&P 500 is the driver of incremental sales, then this investment product is DOA. But it gets worse.

Episodic eras - We've been in a stock bull market for twelve years now. Since Feb 28, 2009, the S&P 500 has returned an average annual return of 16.9% (through Jan 31, 2021). This boom has been driven by a risk-on, emotion-driven, growth phase for technology, innovation, and clean-energy stocks. Unfortunately, the thought-experiment portfolio returned a lesser 8.8% over this same period. This gap (16.9% for the S&P versus 8.8% for the thought-experiment portfolio) ends any possible consideration for commercial success, i.e., the ability to sell a product.

But, as an individual investor, keep your own investment objectives in mind. Don't cave to the investment industry's need to make money from you . . . instead of for you. For example, if your need, your objective, was to earn at least 7% or 8% over the last twelve years, then perhaps the thought-experiment portfolio might just have been the superior solution for your needs.

But is it a best possible investment solution?

Don't get confused. Don't consider an investment through the lens of the investment industry's (quite logical, for them) lens of commercial success. The investment industry's objective is to grow, which means selling more product, i.e., gathering more assets.

Your need as an individual investor is quite different. It's to achieve your life-long financial objectives. This means earning a certain rate of return, or better. Your objective has pretty much nothing to do with beating the S&P 500 Index.

Think about this for a moment. Yes, the thought-experiment portfolio returned 14.5% over the last 102 years versus a lesser 10.3% for the S&P 500. But you don't have 102 years, none of us do.

Perhaps you have an investment time horizon of just 7½ years. What then? Well, the data provides an answer. If you only have 7½ years, then investing in the S&P 500 would have given you a 98% probability of earning more than **-2.4%** per annum. In contrast, the thought-experiment portfolio would have delivered a 98% probability of generating more than **+5.3%** per annum.

Which would you rather have? Which do you prefer, **-2.4%** or **+5.3%**?

Or . . . if you only have 7½ years, then investing in the S&P 500 would have provided a 95% likelihood of earning more than **-0.4%** per annum. In contrast, the thought-experiment portfolio would have given a 95% likelihood of generating more than **+6.6%** per annum.

Which would you rather have? Which do you prefer, **-0.4%** or **+6.6%**?

This comparison well highlights what might be best for you as an individual investor . . . as opposed to what might best serve the commercial interests of the investment industry. Don't let them confuse their needs for yours. Avoid the siren call from the industry's salesperson, hawking what did well over the last several years.

Trust but verify

One of our nation's past presidents often used the phrase "trust but verify." This is a prudent approach when dealing with all investment strategies. Thankfully, the portfolio construction rules and the underlying data that define the thought-experiment portfolio are fully transparent and readily available. It is a simple and straightforward exercise to confirm the validity of the numbers presented above. And we will help anyone who would like to give it a try.

Next steps

Your financial advisor has a menu of possible investment solutions. The solution that is most appropriate to your unique needs and circumstances can only grow out of a meaningful discussion with your advisor. Reach out to them, talk with your advisor.

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Important disclosures

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The data underlying the results, is monthly total return index data. This index data starts on 01/31/1919 and ends on 2/1/2021 and was provided by Global Financial Data, Inc., San Juan Capistrano, CA on 2/24/2021. Global Financial Data, Inc. can be reached at www.globalfinancialdata.com.

The thought-experiment portfolio was constructed as follows:

- The portfolio consists of the seven best performing asset classes, as measured over the prior eleven months, just completed.
- The seven best performing asset classes are revised once each month at month-end closing values.
- The portfolio is rebalanced monthly, and uses equal-weights) at all times.
- The seven best performing asset classes are selected from the 31 passive indices listed below under the sections titled: U.S. Stock Indices, U.S. Bond Indices, International Stock Indices, International Bond Indices, and Commodities.
- The term “seven best performing” is defined as which seven asset classes (drawn from the 31 passive indices) had current month-end index values that were the furthest above (in proportionate percentage terms) their respective average levels over the just completed eleven months (using month-end total return index levels).
- You may request to receive the:
 - Historical monthly asset class weightings for the portfolio from your advisor. This data shows the exact composition of the portfolio, month-by-month, throughout its entire history.
 - Average weightings to the eight major asset categories comprising the portfolio since inception. These major asset categories are defined as: U.S. stocks, International stocks, U.S. Treasury bonds, Liquid investment grade U.S. corporate bonds, U.S. high yield bonds, International fixed income, Gold, and Other commodities.
 - Assumed one-way transactions costs for each of the 31 asset categories. These range from a low of 0 basis points for the GFD Indices USA Total Return T-Bill Index to a high of 32.95 basis points for a basket of precious metals consisting of gold (0.030oz), silver (1.100oz), platinum (0.004oz), and palladium (0.006oz).

U.S. Stock Indices - (1) S&P 500 Total Return Index (w/GFD extension), (2) S&P 500 Utilities Total Return Index 55, (3) Dow Jones Industrials Total Return Index, (4) Dow Jones Transportation Average Return Index, (5) S&P 500 Industrials Total Return Index 20, (6) Energy (Fama French, Market value-weighted portfolio, Total returns, Market broken into 10 industry portfolios), and (7) HiTech (Fama French, Market value-weighted portfolio, Total returns, Market broken into 10 industry portfolios).

U.S. Bond Indices - (1) GFD Indices USA Total Return T-Bill Index, (2) USA 30-year Government Bond Return Index, (3) USA 5-year Government Note Total Return Index, (4) USA 3-year Government Note Return Index, (5) GFD Indices USA 10-year Government Bond Total Return Index, (6) BofA Merrill Lynch US Inflation-Linked Treasury Total Return Index, (7) Dow Jones Corporate Bond Return Index, (8) GFD Indices USA Total Return AAA Corporate Bond Index, and (9) Bloomberg Barclays US Aggregate Bond Index

International Stock Indices - (1) UK FTSE All-Share Return Index (w/GFD extension), (2) Japan Topix Total Return Index, (3) Germany CDAX Total Return Index (w/GFD extension), (4) Australia ASX Accumulation Index-All Ordinaries, (5) OMX Helsinki All-Share Gross Index - Finland, (6) OMX Stockholm Benchmark Gross Index (GFD extension - Sweden), (7) OMX Copenhagen All-Share Gross Index - Denmark, (8) France CAC All-Tradable Total Return Index, and (9) Brussels All-Share Return Index (w/GFD extension) - Belgium.

International Bond Indices - (1) GFD Indices World x/USA Countries Government Bond GDP-weighted Return Index.

Commodities - (1) Gold Bullion Price-New York (US\$/Ounce), (2) A basket of precious metals consisting of gold (0.030oz), silver (1.100oz), platinum (0.004oz), and palladium (0.006oz), (3) Reuters CRB Total Return Index (w/GFD extension), (4) Silver Cash Price (US\$/Ounce), (5) Palladium (USD per Troy Ounce).