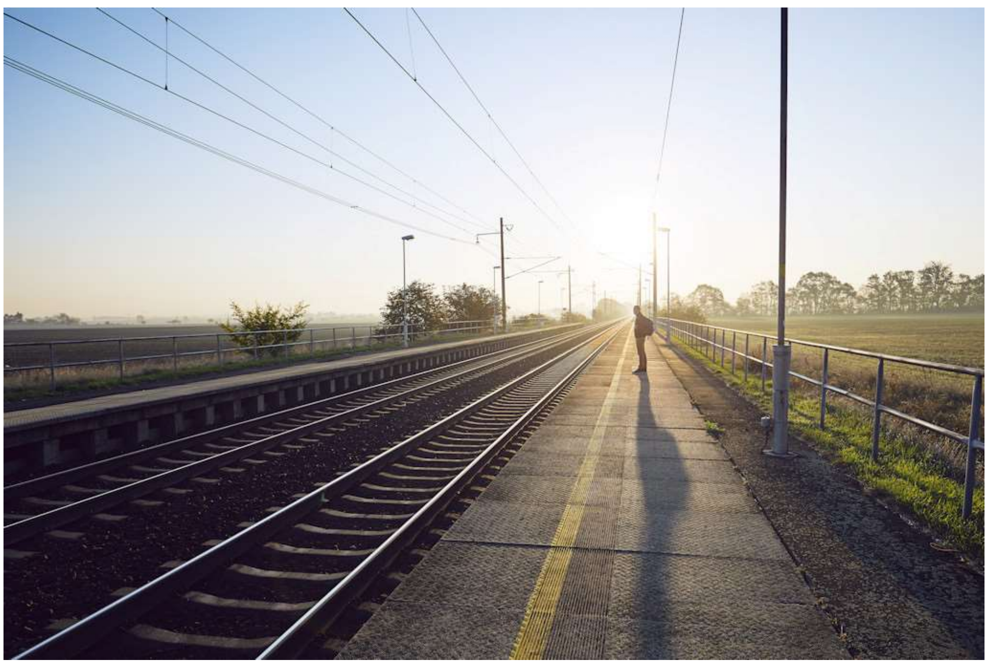
SHINNECOCK PARTNERS

Why did I marry my first spouse?

By Alan Snyder

Because… we had great.... you fill in the blank. (Am sure you thought "love.") A similar perspective-setting question applies to investing. Why do we do it? This question, infrequently asked, sets the stage for intelligent portfolio construction.

Perspective Counts



If answered with "I want to get rich," or in some cases, "richer," many would note how dumb the response and the responder. In our contrary nature, let's be the naysayer - "absolutely a reasonable answer when added to, what is the timeframe?" If instant gratification is sought, the risk of total loss can be equally swift and hardly seems like a durable and repeatable portfolio strategy over time.

For some perspective on this lust for easy riches, $72 billion was spent in 2019 on lottery drawings. Were the purchasers all ill-educated poor folks? Not hardly. 53% were upper income and 45% had post graduate degrees. It doesn't stop there. 26% of the U.S. population wagers in casinos and 15% on sports. Some estimate that $79 billion is spent here including online gaming, with a 10% annual growth rate. (Draft Kings anyone?)

We see this speculative furor of getting rich now (!) currently hitting the investment world. Non-fungible token purchases, a.k.a. NFTs, are reminiscent of tulip mania. A one-location deli with sales of $35,000, Hometown International, reached a high valuation of $100 million. Coinbase Global went public at a 10x multiple over its last financing round and dramatically eclipsed the valuation of NASDAQ. SPACs, another form of blind pool, raise billions and purchase early-stage companies at incredible valuations. Lastly, a friend texted me that his son bought Bitcoin and made 1000%. Now, he styles himself an investment guru needing to educate his hapless investment advisor father in this new and improved approach. Being Cassandra, Chicken Little or a killjoy about these wagers is to be just the scold. Aggressive bets in the context of a complete portfolio approach with all of the other considerations, may be logical as described below. Clearly and even in intelligent investing, this itch can be addressed, but how?

Most of us seek a more complete portfolio approach that can endure, transcending speculative frenzy no matter how beguiling. Many pundits write that the tried and true 60% equity/40% bond portfolio is dead and no longer a relevant solution. However, we should not act so hastily. The traditional 60/40 portfolio outperformed most other asset mixes over the past 40 years. Nevertheless, that period was a bull market for bonds with interest rates steadily dropping from high teens to current lows of 1% - 2%. Equities did well also. We believe this baby should not be thrown out with the bathwater. Time to update it.

Let's steal a page from that hoary construct of the past, the investment pyramid. For our younger readers, the top of the pyramid, and thus the smallest part, would be comprised of the most aggressive investments with lower layers decreasing in risk to the bottom housing the safest. Thus, to update our 60/40 portfolio, put investments from the top of the pyramid into the 60% piece and the bottom of the pyramid in the 40%. The objective is to have the 40% portion bridge the inevitable drawdowns from the 60% in order to smooth out performance and maintain: the power of compounding, liquidity when needed, and psychic comfort. Notwithstanding elevated (if not frothy) current equity markets, consider venture, private equity, preferred and convertible stocks, and more defensive common stock for the 60%. Remember, there are trillions of dollars sloshing about, savings balances are more than peppy, jobs are rebounding, and the populace is anxious to get out and smell the roses.

The 40% can be filled with cash, alternatives deploying various credit strategies (defaults are down albeit subprime auto bears watching), litigation finance (courts are opening to alleviate recent extension risk), insurance linked securities, viatical and life settlements, true supply chain finance (not the concentrated practice of Greensill Capital), classic trade finance, and hard asset lending (our own [lending against museum quality art] at modest loan to value ratios where we possess the collateral fits well). N.B.: There is no mention of intermediate term bonds. These are fraught with asymmetric risk. The upside is modest, yet if inflation were to appear more fully and drive interest rates higher, bonds would sharply decline.

In sum, great portfolios can be constructed... to get rich and richer over time. However, there are caveats:

- Please note compound returns are the eighth wonder of the world for long-term wealth creation (high volatility is the bug bear - a 50% decline requires a 100% gain just to get even).
- Be Elizabethan. Polonius in Shakespeare's *Hamlet* advised his son, Laertes: To thine own self be true." Carefully assess your own risk tolerance.

- ____ happens! Illiquidity return premiums are fabulous if an unforeseen event or opportunity does not demand cash.
- Marry your return expectations to your investment time horizon. Retirement is often the triggering point. The gambling examples highlighted earlier are the get rich quick scenarios, no matter how improbable. The concept of ergodicity applies.

In conclusion, am hoping you agree that a modernized and refreshed 60/40 portfolio remains alluring.