New York Times

February 17, 2008

Keep It Simple, Says Yale's Top Investor

By GERALDINE FABRIKANT

IT has been a time to worry even the savviest investors. The credit markets have been in a crisis, the domestic stock market has been shaky and overseas markets haven't been much better.

What should an individual investor do?

Don't try anything fancy. Stick to a simple diversified portfolio, keep your costs down and rebalance periodically to keep your asset allocations in line with your long-term goals. That is the advice of David F. Swensen, who has run the Yale endowment since 1988, relying on a complex strategy that includes investments in hedge funds and other esoteric vehicles. The endowment earned 28 percent in its last fiscal year, which ended June 30, beating all other endowments. It finished the year with $22.5 billion.

For most people, he recommends a very basic approach: use index funds, exchange-traded funds and other low-cost instruments, and stick to your long-term asset allocation — even when the markets are in tumult.

Don't be distracted by market forecasts, he said. "You have to diversify against the collective ignorance," he said. "I think nobody is in a position to react to these big macro-issues. Where is the dollar going to be or what is G.D.P. growth going to be in China? For every smart person on one side of the question, there is another smart person on the other side."

For most individual investors, he said, copying the strategies of institutions like Yale is virtually impossible: big investors have access to fund managers and arcane strategies that are beyond the reach of most people.

"The only people who should get involved are sophisticated individuals who have significant resources and a highly qualified investment staff," Mr. Swensen said.

"Most people do not have the resources and time to pick market-beating managers" of hedge funds, private equity funds or funds of funds, he said. And he said that the techniques used by hedge funds often result in higher taxes than those of index funds.

So he advocates another approach, which he outlined in the book "Unconventional Success: A Fundamental Approach to Personal Investment" (Free Press, 2005). He proposes a portfolio of 30 percent domestic stocks, 15 percent foreign stocks, and 5 percent emerging-market stocks, as well as 20 percent in real estate and 15 percent each in Treasury bonds and Treasury inflation-protected securities, or TIPS.

The real estate investment can be made through real estate index funds. Though the real estate market has declined and your portfolio is below its target allocation to it, he said, don't try to time the market. Go ahead and rebalance because no one really knows where the market's bottom is.

Diversification will buffer a portfolio from declines in specific asset classes. For example, he said: “If the dollar declines dramatically, you have foreign and emerging-market equities. And a declining dollar may well be associated with inflation, but a diversified portfolio would include TIPS,” to provide a hedge. “That means if any of these scenarios play out, an investor has sizable chunks of his portfolio that protect against them,” Mr. Swensen said.

When possible, he said, rebalancing should be done in a tax-sheltered account, like an I.R.A. or a 401(k), to avoid tax liabilities. “When you are putting fresh money to work,” he said, “you put it in an asset class where you are underweight and take money out of a class that is overweight.”

He says it is fruitless for individual investors to pick stocks. “There is no way that an individual can go out there and compete with all these highly qualified and compensated professionals,” Mr. Swensen said.

HE criticized the approach of Jim Cramer, the CNBC host, who encourages investors to trade stocks in strategies that Mr. Swensen says cost heavily in commissions and taxes.

“There is nothing that Cramer says that can help people make intelligent decisions,” Mr. Swensen said. “He takes something that is very serious and turns it into a game. If you want to have fun, go to Disney World.”

Brian Steel, a spokesman for CNBC, responding on behalf of Mr. Cramer, said Mr. Cramer “had a long history of success as a trader and fund manager.” He added that Mr. Cramer is a proponent of long-term investing and thorough research.

Mr. Swensen says investors should forget market timing entirely. Once an individual sets up a program, it should be rebalanced quarterly or semiannually, he said, “but it should be disciplined.”

When the markets decline, try not to pay attention, he said. “Let yourself off the hook,” he said. “If you pursue the sensible long-term policy, look at it over a 5- to 10-year period. Don’t look at five months.”