

World Cup Diversification

There is no greater sporting event on the planet than the FIFA World Cup currently underway in South Africa. While the ClearRock team's daily television viewing is usually restricted to the Bloomberg channel, we recently have been taking short breaks from the rigors of research and portfolio management in order to sneak peeks at the incredible football spectacle that occurs only once every four years. After all, like all good portfolio managers, we are always seeking ideas, inspiration, and information from non-traditional sources (in addition to the more common ones).

For example, we have taken note of some strong parallels between fielding a successful World Cup team and managing a successful investment portfolio. One can imagine the best soccer coaches constructing an optimal team much the same way a portfolio manager weighs the various asset classes and sectors in creating the optimal portfolio: in both instances, one needs to strike a balance between an outstanding offense and a strong defense. But perhaps the most striking similarity can be described by one word: diversification.

As any World Cup coach knows, relying on one star player won't guarantee success. A season-ending injury could eliminate his team's chances for a winning year. Likewise, a good portfolio manager can't rely on any one stock, bond, or sector to help clients reach their financial goals. Rather, a diversified approach in which the sum of the parts is greater than any one element is critical in delivering success in both cases.

But diversification is more than just spreading the risk. A good coach knows that how you construct the team, what players are fielded at what time during the game, and how the players fulfill their assigned roles are all essential ingredients to winning. In our world, we know that diversification for diversification's sake is not sufficient: a more thoughtful, disciplined researched-based approach is essential to the long-term preservation and growth of capital. Each component of the portfolio, like each member of a successful World Cup team, plays a specific role in its overall success.

The concept of diversification is one of the most important tenants of business. There is no better place to observe this than the streets of Manhattan. If you wake up one morning in New York City to a torrential downpour, you'll immediately notice umbrella salesmen on the street corners. When the sun comes out a day later, the umbrella salesmen will give up their corners to sunglass or hat vendors. But, the most successful vendors are out there every day selling all three: *umbrellas, sunglasses, and hats*.

The point is this: a vendor (or a portfolio manager for that matter) who wants to succeed over a long, often unpredictable time horizon will sell merchandise that is unrelated (or uncorrelated in the parlance of Wall Street) in an attempt to ensure that they have customers every day of the week. The diversified vendor knows that no one will buy everything he is selling every day, but by offering all three, he can greatly reduce the risk of losing money on most days. Clearly, no one can predict the weather any more than anyone can predict the financial markets. Consequently, if one wants to minimize losses on any given day, one needs to have a broadly diversified product line.

To bring this concept closer to home, we point to our Green (conservative) Model performance over the twelve months ending 6/30/10. Our multi-asset class portfolio contains domestic stocks, foreign stocks, bonds, commodities, and real estate. During this period, the S+P 500 index rose 12.12%, the Barclay's Treasury Bond index was up 5.82%, and the EAFE (International) index was up 1.53%, our Model was up 7.07% (net of fees).

Another important lesson we take away from the World Cup is that of durability, the ability to withstand challenges over a long period of time. Although they missed this year's final, no single team has dominated World Cup play more than Germany. Over 16 World Cup tournaments the Germans have lifted the famous trophy three times, finished runners up on four occasions and have not failed to reach at least the last eight since 1938. It's a remarkable record and one that has been achieved without an individual superstar. German football writer and historian Uli Hesse traces their success to a 1954 game in which the team recovered from a 2-0 deficit to win 3-2. "Since that game, we have placed a premium on team

effort and spirit rather than individual class.” Durability over time, diversification and teamwork: we can think of no better way to help our clients reach their financial goals.

The ClearRock Capital Team

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