WSJ ARTICLES

§6. INVESTMENT VEHICLES

The Hedge Funds that Changed the Game (February 23, 2024)

Key takeaways

Hedge fund behemoths Citadel, Millennium, and Point 72 pioneered the multimanager model. While these funds have fared well lately, there competitors have struggled to outperform interest on cash, perhaps because they have not spread their bets widely enough. Yet, hedge fund performance may not necessarily be "benchmarked": the goal is often to earn money in any environment. Such an organizational structure may be attractive when creating hedge funds given the fee structure.

Terms and topics

- Multimanager firms
- Market neutral
- Stabilizers
- Pass-through fee model
- Citadel, Millennium, and Point 72

Quote

"Their method turns on its head the original idea of a hedge fund as the strategic vision of just one manager."

Notes

Investors Are Piling into Actively Managed ETFs (May 2, 2023)

Key takeaways

Active funds make up less than 6% of total ETF assets but have attracted 30% of flows in the first several months of 2023. Market volatility appears to attract investors to active management. However, years of research shows actively managed stock portfolios underperform broad indices.

Terms and topics

- Defensive stocks
- Passive investing
- Dimensional Fund Advisors

Quote

"'Dimensional is becoming the Vanguard of active funds,' said Elisabeth Kashner…'They're doing what Vanguard did in the plain vanilla index ETF space but for active funds.'"

Notes

The Best Stock Funds of 2023 (January 7, 2024)

Key takeaways

The best stock funds of 2023 were in part driven by the performance of the Magnificent Seven and weightings in the technology, communications services, and consumer discretionary sectors. Large-cap growth stocks lead the way. However, the top performers in a given year aren't frequently the top performers in prior (or future) years.

Terms and topics

- Magnificent Seven
- Consumer discretionary sector

Quote

"As always, this quarterly competition isn't designed to create a 'buy list' of funds for readers…Some of the funds that were highlighted a year ago have fallen in the rankings – and that phenomenon isn't uncommon. Take the latest No.1 fund, for example. [It] lost 55.4% in 2022 and 10.1% in 2021."

Notes

Your Mutual Fund Stinks. (January 24, 2024)

Key takeaways

ETFs have emerged as attractive alternatives to mutual funds. Mutual fund companies are offering ETF share classes of their mutual funds to prevent outflows. Such a structure can protect long-term mutual fund investors from the tax implications of those who wish to exit. This feature, however, could potentially entice investors to hold onto bad portfolios.

Terms and topics

- ETF share classes
- Tax efficiency
- Predatory traders

Quote

"By combining the ETF and the mutual fund, the tax advantages can be shared by both. 'It's a symbiotic relationship,' says Gus Sauter,…who codeveloped the idea of ETFs as a share class alongside a mutual fund…Sauter's idea was to protect the mutual fund's long-term investors from 'the ones that might panic.'"

Notes

Are Leveraged ETFs Worth the Costs and Risk? (September 2, 2023)

Key takeaways

Leveraged ETFs use futures and other derivatives to deliver returns that amplify the returns of an underlying index. The article argues that tracking error can be substantial and for certain benchmarks the 3x portfolio *underperforms* the index itself. However, leveraged ETFs seek a return that amplifies the single-day return of an index.

Terms and topics

- Tracking error
- Nasdaq-100
- Russell 2000

Quote

"The 3X ETFs for the Russell 2000 actually performed worse than the Russell 2000 index itself. By investing in the leveraged ETF, an investor would have underperformed the actual index due to severe tracking error."

Notes

Is Your 401(k) Destroying Capitalism? (March 4, 2024)

Key takeaways

401(k)s and passive investing allocates investment capital to firms based on those firms' presence in an index. Active fund management often fails to beat the market, so passive investing offers a cheap alternative. Yet, this rationale is predicated on the value of assets being adequately reflected in their price, which *requires* active management to some degree. And what does this mean for proxy voting?

Terms and topics

- 401(k)
- Target-date funds
- Issuing stocks and buybacks
- Free-riding
- Balanced investment strategy

Quote

"Serious people are again pointing to what they say are the hazards of retirement funds on autopilot…the huge sums being plowed into stocks and bonds with regard only to price, not value."

Notes

§7. Risk and Return

Getting the Sharp End of the Investing Stick (April 23, 2023)

Key takeaways

Some funds offering private investments make claims regarding their Sharpe ratios. However, these funds deal in illiquid assets. The Sharpe ratio should be used for publicly traded assets whose prices fluctuate, since it uses standard deviation of returns as an input. Public debt does not necessarily fluctuate in value frequently due to its illiquidity, but that should not imply it is riskless. Further, investments in such funds may include restrictions on when investors can withdraw their money, which can enhance risk.

Terms and topics

- Private investments
- Private debt/private credit
- Beta
- Sharpe ratio
- Interval funds

Quote

"What if instead of buying the funds, you bought stock in the firms offering them?...Apollo Global Management Inc., Blackstone Inc., Carlyle Group Inc. and KKR & Co., offer private-credit funds."

Notes

§8. Capital Allocation

'In Pursuit of the Perfect Portfolio' Review: Models and Mavens (January 4, 2022)

Key takeaways

The book *In Pursuit of the Perfect Portfolio* discusses opposing views of the markets. Fama's EMH is supported by the success of passive investing strategies. Other ideas, like Sharpe's CAPM model that linearly relates returns to risk, have been controversial. Nobel-prize winning academics argue both for and against efficiency and its implications. Markets are "human," thus, the perfect portfolio doesn't necessarily exist.

Terms and topics

- Shiller's CAPE
- Adaptive markets hypothesis
- Bubbles
- Tail risks/tail gains

Quote

"Academia's resistance to abandoning models is nowhere better evidenced than in the famous collapse of Long-Term Capital Management, a hedge fund run by several of the most brilliant finance academics. Reflecting on its blowup, the distinguished professor and co-founder of LTCM Robert Merton said that 'errors were made and unforeseeable things happened . . . But the crisis was not precipitated by an error in the models.' In other words, it's the market's fault, not the model's."

Notes

§9. Capital Allocation

The 60-40 Investing Strategy Had Worst Year in Generations (October 19, 2023)

Key takeaways

The 60-40 stock-bond portfolio has been a time-honored strategy for investors. The two-decade high in the correlation between stocks and bonds has upended this strategy. The rapidly rising interest rate environment of 2023 has hurt both stocks and bonds. This does not necessarily imply that the strategy is dead.

Terms and topics

- Money market funds
- Alternative investments
- Risk-parity portfolio

Quote

"'The problem isn't higher rates, it is when they are rising rapidly like in 2022,' [Aliaga-Diaz] said... A gentle climb in Treasury yields can reflect a healthy economy and provide investors with more income. But when rates rise rapidly, it can destabilize markets, giving companies little time to adjust to elevated borrowing costs and spurring investors to rethink the value of stocks."

Notes

Harry Markowitz (NYT) (June 25, 2023)

Key takeaways

Harry Markowitz pioneered modern portfolio theory, which shows that the risk of a portfolio depends on how assets in the portfolio comove, in addition to their own levels of riskiness. Prior to his discovery, the portfolio creation process was haphazard. He was the first to codify and quantify the benefits of diversification by looking at correlations and variations from the mean.

Terms and topics

- Efficient frontier
- Computerized arbitrage trading
- Prospect theory/loss aversion
- Dividend discount model

Quote

"[I]f investors were interested only in the expected values of securities, he figured, then that implied that the best, or maximized, portfolio would consist of the single most appealing stock. 'This, I knew, was not the way investors did or should act,' he concluded. 'Investors diversify because they are concerned with risk as well as return.'"

Notes

§10. Optimal Risky and the Complete Portfolio

Advisers Question Modern Portfolio Theory (December 17, 2012)

Key takeaways

Modern portfolio theory was originally derided, but views changed in the 1980s as the stock market climbed steadily and diversification appeared to capture returns while limiting losses. This persisted until the 2008 financial crisis. Some argue the approach is too much about "asset allocation" and less about being a *shareholder* of a security. It is important as a tool when selling investment products to investors (like pension funds) familiar with the strategies.

Terms and topics

- Black swan
- Risk appetite

Quote

"For investing expert Bryce James, this makes MPT about as useful in constructing portfolios as the Farmer's Almanac is for predicting the weather from day to day. 'Sometimes it works, but mostly it doesn't,' says the chief executive of Smart Portfolios, a separate account manager in Seattle."

Notes