Invest Outside the Box

Tariq Dennison

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Understanding Different Asset Classes and Strategies

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Tariq Dennison
GFM Asset Management
Hong Kong, Hong Kong

ISBN 978-981-13-0371-5 ISBN 978-981-13-0372-2 (eBook)
https://doi.org/10.1007/978-981-13-0372-2

Library of Congress Control Number: 2018943805

Cover Design by Oscar Spigolon

Printed on acid-free paper

This Palgrave Macmillan imprint is published by the registered company Springer Nature Singapore Pte Ltd.
The registered company address is: 152 Beach Road, #21-01/04 Gateway East, Singapore 189721, Singapore

Preface: How Boxes Define Investing

This book aims to be one of the most concise introductory guides to investing across many different markets. Many of these investment categories or styles may be outside the comfort zone of non-professionals, or of investment professionals specializing in one of the other "boxes" looking for a refreshing view on another investment "box". Each chapter is meant to be a modular guide to many widely siloed "boxes" of investments, whether boxed by asset class (stocks vs bonds), style (active vs passive, growth vs value), instrument (direct shares vs fund vs ETF vs blockchain), or region (United States vs China), explaining for each of these boxes:

- What each "investment box" is
- Why invest in or avoid investing in that "box"
- Concepts and techniques for understanding and evaluating each "box"
- How to better profit from investing in that box by challenging the conventional wisdom often written on it and by breaking behavioral boxes

There are many books in the field of investing, but this one seemed timely as the post-2009 bull market in stocks and bonds, sometimes termed the "bubble in everything", has been explained by acronyms like "TINA" for "there is no alternative". Not knowing where else to put money is one of the poorest reasons to buy stocks or a piece of real estate and is one of the main reasons many often overlook foreign markets or alternative assets. Investors able to proficiently navigate outside the traditional boxes can expect higher investment returns by buying assets that few competitors are buying at the same time.

This book can be thought of in three parts:

- Part I describes asset classes: stocks vs bonds vs real estate vs currencies vs alternatives. This could be considered the box of "what" to invest in.
- Part II describes different strategies, in other words the "how" boxes of investing.
- Part III surveys several different foreign markets in Chap. 10, and some of the irrational patterns and opportunities seen in the field of behavioral investing in Chap. 11. Part III calls these the "where" boxes and "why break the boxes".

More advanced investors may find some of the topics and explanations basic but are likely to find even "textbook" financial solutions applied in a practical way few academics go into and even fewer funds actually implement. One key example of this is the illustration of how to "beat Berkshire by balancing Berkshire, bonds, and borrowing" in Sect. 7.3 on mean-variance optimization.

Some distinctive goals and features of this book include:

- For readers with no background in finance or investing, each chapter begins with an elementary explanation of each investment "box". Together, the chapters develop a working knowledge across several different types of investments.
- Active investors or investment professionals already focused in one of these investment boxes will find this book a concise and useful introduction to different asset classes, strategies, and regions which may be outside their current comfort zone.
- Unlike many investing textbooks, this book is mostly from the author's own experience with these different asset classes, geographies, and strategies from 1997 to 2017, and answers more of the "why" and "what I do differently" questions rather than just the "what" and "how" of investing in each box.
- This book takes a mostly "outside view" of each investment box, focusing on the bigger questions of diversification and risk/reward, rather than deep analysis on any one type of investment. At times, references are made to other books and sources that go deeper into these topics.

Other than the foundational knowledge in fixed income, asset allocation, and portfolio construction that this book assets as the most important base for almost any investor, the emphasis is on breadth rather than depth with the goal that most readers will be inspired to consider investing in boxes other than ones they were earlier comfortable with.

The first chapter on bank deposits may seem extremely basic for even most non-finance professionals, so is the one chapter many readers may choose to skip or skim through, or use as a guide to the other chapters through the many references there. The second chapter on bonds is one of the longest and most foundational, since in many ways understanding bonds is a base for understanding most other types of investments.

Doing anything "outside the box" may sound like a cliché, but investing uses box terminology in at least three different ways:

- whether an investment is viewed from the inside or outside, and as a "black box" or "white box",
- the "boxes" into which investments are classified, and
- investment processes we use to see if a given investment "ticks the boxes".

First, any investment itself can be viewed as a box into which an investor puts money now with the expectation that the box will return more money at a later time or times. This is a simple but liberating view that helps make clear how $1,000,000 in stock paying $50,000/year in dividends has a lot more in common with a $1,000,000 building paying $50,000/year in rental income than might be obvious to an investor with experience in only stocks or only real estate. To oversimplify the work of Nobel Memorial Prize in Economics winners Daniel Kahneman and Amos Tversky (two of the best known scholars in behavioral finance referenced in Chap. 11), the "outside view" that both boxes paying out $50,000/year can often be both more reliable and less labor intensive than the "inside view" of a stock analyst or property consultant who believes they might have some edge in understanding why their chosen stock or building is likely to outperform other investments.

This "outside view" is one way of understanding the explosive growth of exchange-traded funds (ETFs) in the first two decades of the twenty-first century, as explained in more detail at the end of Chap. 8.

Second, there are boxes defining which investments we will consider for different boxes of our money. For example, we may use bank deposits for short-term cash that has to be kept safe, bonds for long-term income, rental real estate for inflation-protected income, and stocks for long-term growth in a retirement account. Within each of those boxes, there are sub-boxes where we may consider, for example, domestic vs foreign stocks, residential vs commercial real estate, and high-yield corporate taxable vs high-grade municipal tax-exempt bonds. It is well documented that too many investors invest too little outside their home country and/or are too concentrated in one asset class (or even one asset), and so lose out from the benefits of spreading their risk across different boxes.

Thinking of asset allocation in terms of filling and balancing our boxes of needs, Chap. 3 describes an extremely simple inflation-tracking portfolio allocation called a "Four House Pension" made of only four literal houses. 100% property portfolios are practiced by some investors who don't venture into investing in securities or businesses, but a major goal of this book is to help such investors better visualize how to diversify by replacing one or more of the "houses" in their portfolio with a different asset class or investment strategy.

Third, there are the boxes ticked in checklists when deciding whether or not to make an investment, ensuring it meets our requirements for liquidity, transparency, inflation sensitivity, or other factors. Institutional investors are known to have mandates limiting them to investments that "tick all the boxes", but unconstrained investors also benefit from knowing which boxes they tick consciously or unconsciously when making an investment decision. Investment professionals who simply "tick the boxes" are sometimes regarded as inflexible and unsophisticated, but having a checklist to make sure important steps are not overlooked has literally been a lifesaver for pilots, surgeons, and other professionals where consistency is at least as important as intuition or memory.

The parts of this book are mostly organized along four dimensions of the second type of box: asset class, investment style or strategy, instrument or packaging, and geography with illustrations of "ticking the boxes" and taking the outside view of different boxes used throughout. A thorough understanding of each of these different boxes, and how to best apply them, can prevent an investor from getting too concentrated in one comfort zone and instead better find, understand, and more confidently invest in opportunities across diverse markets.

Hong Kong, Hong Kong — Tariq Dennison

Acknowledgments

This book was a lot of work, and I have many people to thank for helping me complete it.

First of all, I can only thank God and my parents, John and Sue, for having been born, raised, and educated in the late twentieth century in a prosperous and peaceful time and place. It is easy to take for granted the upbringing and privileges that have let me see, do, and learn the things I have been able to do. The many travels my parents took me on as a child implanted in me the desire to see the world, to spend most of my life living outside my home country, and to never stop being curious and fascinated by different people and places.

Second, I thank my wife, Aquin, and children for their amazing support given the time and attention I have had to commit in completing this as my first book. My elder son, Isaac, especially has motivated me with his questions and his desire to go to more countries I've been to, while my younger son, Augusto, challenges me by already speaking better Chinese than I do. My family reminds me I'm still young, still have a lot of work to do, and have a home team that will be proud of the work I do in my time away from them.

I also wish to thank Frank Lavin for his encouragement to write my first book and for the introduction to the team at Palgrave Macmillan, who have been a pleasure to work with.

Many thanks to Professors Emanuel Derman and Terry Odean, to my former Bear Stearns colleague Edward Ho, and my former Bear Stearns and CIBC boss Bill Bamber for initially reviewing the outline and helping this book get started. I especially must thank Bill for his support during the rise of my Wall Street career, where I learned on the job how many of these markets really work.

Also, I owe a debt of gratitude to former HKSFA director Tony Watson, CFA Singapore director Francis Er, and ESSEC professor Peng Xu for providing me the opportunity to share and teach what I've learned in the markets to Asia's current and future money managers.

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