

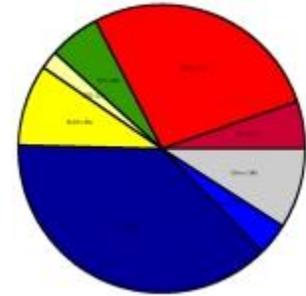
From Physician's Financial News

The 15% Solution: A Critical Investing Concept

By Shirley M. Mueller, MD Published on March 17, 2008

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In fiscal year 2007, Mohammed El Erian, PhD earned a 23% return for Harvard's Management Company. As president and CEO, he managed the university's \$34.9 billion endowment, and another \$6.1 billion in other accounts, including retirement funds.



How did Dr. El-Erian do this? He simply changed the endowment mix used by his predecessor to a larger number of asset classes, in fact seven, with about 15% in each asset class.

Double the Fun

In 2007, Craig L. Israelsen, PhD did a retrospective study of asset mixes that yield the best return with the least downside risk. He found that a portfolio of seven different asset classes outperformed other possibilities that included fewer classes, [Scientific Approach to Nest Egg Protection](#).

What the two economists have in common is that their favorable results are linked to the use of increased non-correlated asset classes,* rather than the traditional three, four or five. In this way, they introduced more possibilities for balancing market fluctuations because more asset classes enhance the benefits of correlation when chosen appropriately. Dr. Israelsen's results were retrospective and Dr. El Erian's were prospective.

This is how the average physician-investor can use this information to an advantage. The traditional 65% stock/35% bond or 60% stock/40% bond that includes three-five asset classes is ready for a makeover. This critical concept is "the 15% solution." It's based on Drs. El Erian's and Israelsen's use of seven different assets, 14% to 15% in each, in their portfolio construction. This enhanced mix pumped up portfolio performance and diminished risk.

Dr. Israelsen used the following seven asset classes: Large US Equity, Small US Equity, Non-US equity, US Intermediate Bond, cash, REIT and commodities, putting 14.3% in each. Exactly what asset classes Dr. El- Erian used is unclear, although a February 2008 article in Pension and Investments indicated, he "simply built a more diversified "alpha" engine, distributing the endowment's risk budget more evenly across a greater number of asset classes and portfolio managers." Dr. El-Erian said in a 2007 [CNBC interview](#) with Michelle Caruso-Cabrera that he was using 15% each of different asset classes in his portfolio.

Portfolio Makeup

The average doctor-investor can achieve a portfolio loosely similar to Drs. El-Erian and Israelsen

by using low cost index funds. Several different companies including Vanguard and Fidelity offer these. For example (from Vanguard):

Large US Equity—Vanguard Large Cap Index Investor Shares VLACX

Small US Equity—Vanguard Small-Cap Index Fund Investor Shares NAESX

Non-US equity—Vanguard Total Intl Stock Index Investor Shares VGTSX

US Intermediate Bond—Vanguard Total Bond Market Index Investor Shares VBMFX

Cash

REIT—Vanguard REIT Index Fund Investor Shares VGSIX

Commodities—Vanguard Precious Metals and Mining Fund Investor Shares, VGPMX, now closed to new investors, but may reopen in the future. An alternative is the recently launched Green Haven Continuous Commodity Exchange Traded Index Fund (GCC). It lowered its expense ratio from 1.95% to 1.09% per annum shortly after opening. This is more than VGPMX, but less than some others in the commodities category.

The point here is that the successful results of El-Erian and Israelsen are unlikely to be a coincidence. They both used the 15% market solution—seven asset classes instead of three, four or five. The 15% market solution is a strategy that works theoretically (Israelsen) and practically (El-Erian). A little more “addition and mix-up”—that is, adding more asset classes that differ in characteristics from those already in the portfolio—goes a long way in making an investor’s portfolio less likely to lose value in a downturn and more lucrative overall.

** Correlation refers to the movement of asset classes in a particular market. Those that highly correlate go up and down together. Those that have low correlation do not.*

About Shirley M. Mueller, MD

Dr. Shirley Mueller is a physician turned financial consultant and investment educator. She teaches others how to invest their own money using a Noble Prize-winning financial strategy. Her fee is hourly, not a percentage of assets. She welcomes comments at ShirleyMMueller@MyMoneyMD.com. For more information, visit her website at MyMoneyMd.com

