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THE OLD BROMIDE, "DON'T PUT ALL YOUR EGGS IN ONE BASKET" EXPRESSES AN IMPORTANT TRUTH ABOUT DIVERSIFICATION OF RISK IN AN INVESTMENT PORTFOLIO. UNFORTUNATELY, WE TOO OFTEN SEE IT MISAPPLIED TO INVESTMENT ADVICE. THE RESULT? OVERLAPPING ADVISORS, ISLANDS OF CAPITAL, REDUNDANT INVESTMENTS, CONTRADICTORY HEDGES, AND ACCIDENTAL CONCENTRATIONS OF RISK.

On Eggs, Baskets and Taylor Swift

Diversification of risk, good. Diversification of advice, not so much.

BY WILLIAM KENNEDY, *Chief Investment Officer*

Most bromides, however trite, have at least kernel of fact to them, usually so obvious it need not even be said:

> *Sometimes less is more.* (Unless more is more, but I get the sentiment.)
> *Buy low, sell high.* (If only it were that easy.)
> *If my aunt had a mustache she'd be my uncle.* (Anyway, moving on…)

These persist not because they are necessary or particularly instructive, but because they are true. I continually run into another bromide, one that is as familiar as any you could name but very different in that it is both true, and dangerously wrong, all at the same time.

> *Don't put all your eggs in one basket.*

The oldest reference to the phrase points to the realm of King William II of England (c. 1056 – c. 1100). According to legend, the king ordered that eggs be brought to a festival for the coming birth of his daughter. The courtier charged with the request consulted a bishop for guidance. The bishop, oddly, had just dreamt of an incident in which eggs in a basket had been destroyed, and thus counseled the courtier to separate the eggs into different baskets, just in case. The courtier apparently decided the bishop's warning had no relevance to the situation and proudly delivered the eggs in a single basket, which a clumsy servant promptly knocked over, breaking every egg. The legend does not detail what happened to the courtier, however some breakfast historians trace the origin of the omelet to roughly this time.

But I digress.

Centuries later Andrew Carnegie would borrow the phrase and apply it to capital.

> *"The concerns which fail are those which have scattered their capital, which means that they have scattered their brains also. They have investments in this, or that, or the other, here, there and everywhere.* 'Don't put all your eggs in one basket' is all wrong. *I tell you* 'put all your eggs in one basket, and then watch that basket.'*"*
> Andrew Carnegie, June 23, 1885

Carnegie was right. However, as time progressed, he was "corrected" by the investment industry. The industry reapplied the phrase to the concept of asset allocation. And thus was spawned a thousand trite marketing brochures.

It is both true, and dangerously wrong, all at the same time.

But they were right, too. In the proper context, the eggs/baskets idea is an important truism. An essential element of risk management is to determine an appropriate blend of risk exposures (to economic growth, inflation and credit) given your goals and risk appetite. This blend is then expressed in your mix of cash, equities, fixed income, alternatives etc.

It prevents us from putting everything into one thing. If the eggs represent your capital and "one basket" represents a single investment – say, a chain of big-box toy stores, or a cryptocurrency – we all understand it is not going to end well.

However, more and more I am seeing the bromide applied not to the investments but to clients' sources of investment advice. This is where the eggshells start to crack.

In just the last few weeks numerous cases have been brought to the Fieldpoint Private research team in which a family has become frustrated with lackluster investment performance and high fees at their current investment firms. In these instances, working with a Fieldpoint advisor, the team performs a series of portfolio diagnostics, which start by collecting the family's investment statements and loading the information into our analytical systems. These give us a "look-through" to the underlying data and enable us dissect the individual securities held, regardless of the firm in which they reside. We can then recombine the data and perform a series of analyses to understand the investment picture as a whole, and make recommendations.

What are the returns and volatility, in aggregate, and how do they compare with the targets? Is the portfolio delivering alpha (outperformance) or merely matching index (beta) returns, or worse? Does the combined allocation match the objectives to which the family and its advisors committed? Are there bubbles of unintended risk that require attention? Is the client getting value for the fees, given the performance?

In too many cases we see the same dynamic: multiple advisory firms are engaged, each with a pool of capital and a set of objectives; each selecting securities or third-party money managers. The objectives the firms follow may be identical, or different. The advisory firms may or may not be aware of each other, and with rare exceptions they do not coordinate efforts or share data. Instead, they are competing with one another in what is, in effect, an ongoing investment tournament. March Madness, with money.

It is a tournament no one wins, and a misapplication of an otherwise perfectly good bromide.

Instead of deliberate diversification, the family experiences inadvertent concentrations of risk. Or, an alternative manager selected by one advisor unintentionally negates a long position by another. Or, everyone decides big-box toy stores are a good idea, at the same time. It is the investing equivalent of trying to win a football game by hiring multiple head coaches, with no huddles or headsets.

It is a tournament no one wins, and a misapplication of an otherwise perfectly good bromide

A CASE IN POINT

I will share an example we see frequently. Apple.

It seems as if every manager owns it – value managers, growth managers, tech managers, index funds – I could go on. It is a crossover superstar. The Taylor Swift of stocks.

This is neither a knock on Apple nor Taylor Swift, but if the portfolios of multiple, discrete advisory firms contain multiple managers (and ETFs) that all hold Apple, there's a chance you own too much Apple. There's an even greater chance that you don't know it.

The same is likely true of cash – the currency kind, not the Johnny kind.

If your portfolio is split among multiple advisory firms, you can see how much cash each is holding. You can't, however, readily see how much cash their underlying managers are holding. So if you believe you are 5% in cash, and then each of your managers is 5% in cash, your true cash position is much different than you think.

This applies to virtually every other aspect of portfolio management – tax-loss harvesting, hedging, etc.

"WATCH THAT BASKET!"

If you recognize your portfolio and performance in any of the above, please don't hesitate to raise it with your Fieldpoint Private advisor. We stand ready to work with you and your other advisors to take a closer look and help you organize for success. ■

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