A Meta-Rule for Golf and Portfolios

Adam Shapiro

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THERE IS A GOLF INSTRUCTIONAL video on the internet that has been watched over 500,000 times.

Here is a transcript of a key section:

I try to flat load my feet, so I can snap load my power package. That way I can amplify both lag and drag pressure through impact fix. As long as my number two power accumulator doesn't break down, I can reach maximum centripetal force with minimum pivotal resistance.

Got it?

[Spoiler: You are not supposed to. It's a joke.]

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I've been playing golf for over 40 years, always searching for ways to improve. At some point I probably even tried to flat load my feet and reduce pivotal resistance, whatever that means. In the context of really, really wanting to hit the ball longer and straighter, almost any tip can seem worth a shot.

To avoid misguided advice, there is a simple meta-rule that I developed and live by: When I hear a tip, the first thing I do is look to see if it's consistent with the swings of all—or nearly all—great players.

You'd be amazed how many tips I eliminate, or at least consider with caution, based on this approach.

It turns out this meta-rule also works well for portfolio construction. More on that later.

Here are some examples from my golf journey:

1. Instructor to me: "I'd like to see you bow your left wrist at the top of the swing, like Jon Rahm and Dustin Johnson. It will help you shallow out the club on the downswing."

Me: "But what about Ben Hogan and Nick Faldo? They played with cupped wrists at the top, won 15 major championships, and didn't seem to have too much trouble shallowing the club on the downswing."

Bottom line: I find that bowing my left wrist at the top shortens my backswing, robbing me of power and timing. So I don't do it, at least not on purpose.

2. Famous instructor David Leadbetter, for years: "Hinge your wrists as early as you can!"

Me: "I hinge quite late, which is probably not ideal, but look at Tiger Woods and Jack Nicklaus. They hinge very late as well."

> Bottom line: I think Leadbetter has a point that earlier hinge makes it easier to time the transition at the top, and most pros do hinge earlier, but given the Woods and Nicklaus examples I don't think it's a top priority.

I could probably write up 100 more examples, but you get the point.

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The good news is there are a few things that nearly all great golfers do. And the same is true of consistently great portfolios.

Here are images of great golfers at impact. Notice a pattern? They all have their hips open relative to both the target line and relative to their shoulders, and they all have their trail (right) arm at least somewhat bent at impact. Also, the height of their right elbow is very close to their belt line. Copy this and a lot of other things will fall into place (caution: it's harder than it looks).

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Is there a portfolio equivalent of "open hips, bent right arm?"

I think there is.

The champions of endowment investing for the last ten years have been MIT, Yale, Brown, Princeton, and Dartmouth, with annual returns ranging from 10.8% to 11.5%. When I look at what they do, here is what I see in their asset allocation:

ASSET ALLOCATION AMONG LEADING ENDOWMENTS*

	MIT	Yale	Brown	Princeton	Dartmouth
Absolute Return	15.2%	21.6%	25.0%	24.0%	21.0%
Private Investments	51.5%	50.9%	47.0%	48.0%	53.0%
Total "Alternatives"	66.7%	72.5%	72.0%	72.0%	74.0%

** Based on the most recent publicly available information, in all cases within the last four years.*

The very best endowments congregate pretty closely around 71% of their assets invested in "Alternatives." Perhaps that is not a large enough sample, so let's look at more data.

It turns out that endowments that are larger than $1 billion in assets have substantially outperformed endowments that are smaller for quite a long time:

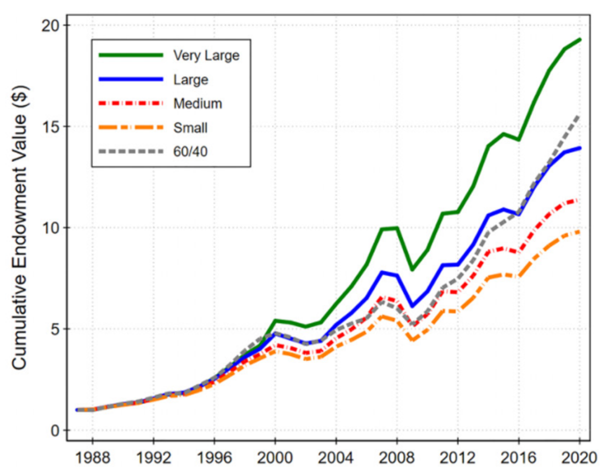
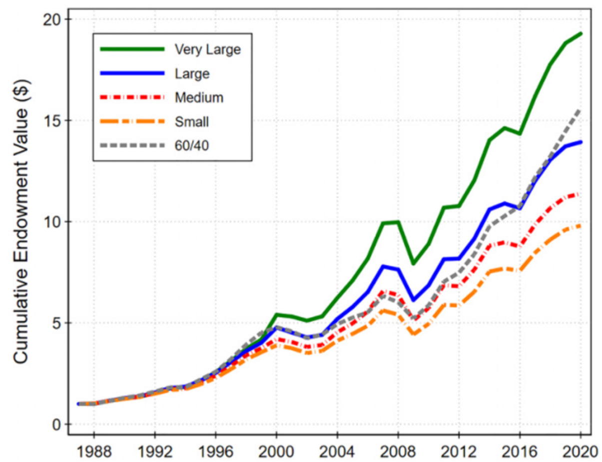


Figure 1. This figure shows the cumulative value of 1 dollar invested in US university endowments in 1987 over time. For the years 1988–97, very large endowments have more than $400 million of total assets, large between $100 million and $400 million, medium between $25 million and $100 million, and small less than $25 million. For the years 1998–99, very large endowments have more than $1 billion of total assets, large between $300 million and $1 billion, medium between $75 million and $300 million, and small less than $75 million. For the years 2000–20, very large endowments have more than $1 billion of total assets, large between $500 million and $1 billion, medium between $100 million and $500 million, and small less than $100 million. The 60/40 portfolio allocates 60% to domestic equity and 40% to fixed income. The 60% allocation to equity uses to the S&P 500, while the 40% allocation to fixed income refers to the Shearson Lehman Hutton Govt./Corp. Index (SLH) for the years 1988–89, the Lehman Brothers Govt./Corp. Index (LB) for the years 1990–2008, and the Barclays Aggregate Bond Index for the years 2009–20. Data come from the NACUBO-TIAA Study of Endowments (Public Tables).

And do you know what else large endowments do? They invest a lot more in alternatives:



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For an insightful analysis of why large endowments outperform, take a look at the paper How Does Human Capital Affect Investing? Evidence from University Endowments by Matteo Binfare, Gregory Brown, Robert Harris, and Christian Lundblad. This paper is the source of the graphs above. Among the conclusions: larger endowments have stronger leaderships and greater resources, which provide a better understanding of the benefits of alternative assets, as well as access to higher-quality managers. The result is that larger endowments make larger, better-selected allocations to alternative assets.

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In golf, disproven adages like "keep your head down" and "grip the club like you are holding an open tube of toothpaste" have largely been relegated to the dustbin.

In investing, there is a similar adage that is past its prime, and it was summarized by none other than Warren Buffett in his 2016 annual letter: "Both large and small investors should stick with low-cost index funds."

With all due respect, this advice is not appropriate for large investors.

As documented in the press at the time, David Swensen and the Yale Endowment took issue with Buffett's statement and pointed out that Yale's total return for the 20 years ending 6/30/17 (12.1% per year) and the return of its absolute return portfolio in the same period (8.9% per year) exceeded the performance of the S&P 500 (7.2% per year).

Yale's conclusion: If you have the resources and access to great managers, active investing offers higher returns than passive investing.

But I think the Yale response sells the story short, because it's not just about higher returns. It's also about minimizing stress and ulcers. S&P 500 investors saw a 25% peak-to-trough drop in 2022, a 34% drop in 2020, and a 19% drop in 2018. Stress may not actually cause ulcers, but it does cause poor decision-making.

As case studies, let's look at two of the worst performing large endowments of the last 10 years ending 6/30/23, University of Wisconsin-Madison ("UW") and University of Utah ("Utah").

What do they have in common? They both had large allocations to public equities in 2013. Based on this positioning, they should have had strong 2013-2023 performance, since the S&P 500 had one of its best 10-year runs in history (up 12.8% per year).

Yet they both performed poorly. UW, which held on to its public equities throughout the period, returned 6.9% per year, while Utah, which launched a strategy shift in 2015, returned 6.0% per year.

What went wrong? The disclosure is far from perfect, but here's what it looks like to my eye:

1. **Almost certainly true:** The endowment managers who built the 2013 portfolios recognized that there was a limit to how much they could responsibly invest in U.S. equities, so they "rounded out" their public securities portfolios with allocations to fixed income (16% in UW's case, 29% in Utah's case) and non-U.S. equities, which diluted performance. Note that while the S&P 500 returned 12.8% per year from 6/2013 to 6/2023, the MSCI World Index ex-U.S. (EAFE) returned 6% per year and the MSCI Emerging Markets Index (MXEF) returned 3% per year.

2. **Perhaps true:** Negative volatility and underperformance relative to peers may have created pressure on leadership teams to act, and that pressure may have resulted in poor decisions at important turning points. Utah, for example, adopted an unorthodox new investment strategy in 2015 following several years of acute underperformance relative to other endowments. The new strategy was announced during a selloff in global equities in which the EAFE Index fell 25% from peak-to-trough. The changes didn't help. As of this writing, Utah's 5-year returns through 6/2023 (6% per year) put it in last place on the Pensions & Investments Endowment Returns Tracker.

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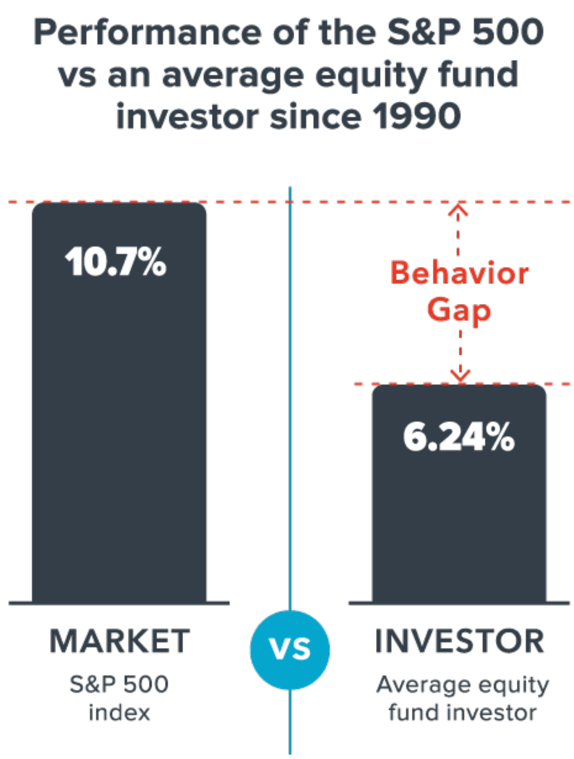
Whenever someone with a large portfolio asks me—and they often do—"why don't I just put all of my money in ETFs?", I think of the factors above and respond:

1. Are you prepared to concentrate 100% of your portfolio in U.S. equities? The U.S. may offer the best investment opportunities, but it has idiosyncratic risks that push most prudent investors to diversify geographically and perhaps include fixed income. If history is any guide, these additions will reduce your expected returns without insulating you from substantial downside volatility.

2. Unless you have the rare iron will to ride out large drawdowns (and do you know that upfront? did you ride through the S&P 500's 55% peak-to-trough drop from 2007 to 2009?) you will likely make mistakes along the way. Most people do, as documented by research firm Dalbar and presented visually by Horizon Investments:



3. If you are a large investor, you don't need the aggravation! A substantial allocation to alternatives mutes volatility via short positions and non-correlated private investing that is not available on public markets, all while delivering higher returns over long periods of time. Avoid the stress and do what the greats do: "open hips, bent right arm."

Golf is all about reinforcing good habits, so here is one last reinforcement. The great Byron Nelson. If I've piqued your interest in golf at all, read about him in The Match: The Day the Game of Golf Changed Forever. Just like Joe DiMaggio's 56-game hitting streak, his 11-tournament winning streak will never be matched. And his impact position is about as good as it gets. Consider it a model for your portfolio.

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Published by **Adam Shapiro**
Managing Partner @ East Rock Capital, LLC | Generational Wealth Manager

EastRock

65 East 55th St, 33 Fl
New York NY 10022

T 212 630 5000
F 212 624 0231
info@eastrockcap.com