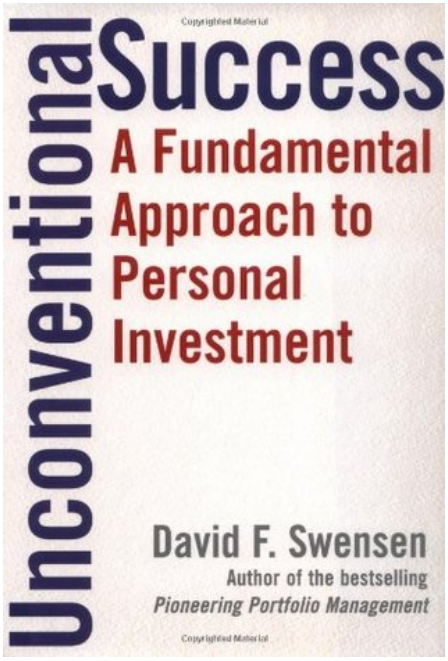

Unconventional Success: A Fundamental Approach to Personal Investment

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The bestselling author of *Pioneering Portfolio Management*, the definitive template for institutional fund management, returns with a book that shows individual investors how to manage their financial assets.

In *Unconventional Success*, investment legend David F. Swensen offers incontrovertible evidence that the for-profit mutual-fund industry consistently fails the average investor. From excessive management fees to the frequent "churning" of portfolios, the relentless pursuit of profits by mutual-fund management companies harms individual clients. Perhaps most destructive of all are the hidden schemes that limit investor choice and reduce returns, including "pay-to-play" product-placement fees, stale-price trading scams, soft-dollar kickbacks, and 12b-1 distribution charges.

Even if investors manage to emerge unscathed from an encounter with the profit-seeking mutual-fund industry, individuals face the likelihood of self-inflicted pain. The common practice of selling losers and buying winners (and doing both too often) damages portfolio returns and increases tax liabilities, delivering a one-two punch to investor aspirations.

In short: Nearly insurmountable hurdles confront ordinary investors.

Swensen's solution? A contrarian investment alternative that promotes well-diversified, equity-oriented, "market-mimicking" portfolios that reward investors who exhibit the courage to stay the course. Swensen suggests implementing his nonconformist proposal with investor-friendly, not-for-profit investment companies such as Vanguard and TIAA-CREF. By avoiding actively managed funds and employing client-oriented mutual-fund managers, investors create the preconditions for investment success.

Bottom line? *Unconventional Success* provides the guidance and financial know-how for improving the personal investor's financial future.

Unconventional Success: A Fundamental Approach to Personal Investment Details

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From Reader Review Unconventional Success: A Fundamental Approach to Personal Investment for online ebook

Chris Leuchtenburg says

This legendary manager of Yale's endowment agrees with me completely. Index funds, buy and hold, asset allocation, avoid tax dodges. He must be right.

This book addresses the question, how should the average person invest for retirement. First, he points out that most employees now have defined contribution rather than defined benefit plans, and that this means that their retirement is less well managed and gets worse returns. Much of the book is devoted to attacking the mutual fund industry for encouraging active security selection and market timing, draining assets with high fees, and producing poor results. As an alternative, he proposes an investment strategy based on a bias towards equities, asset allocation across a small number of asset classes with frequent rebalancing, and passive investment through index funds and rebalancing (against recent market performance) thereby gaining reduced management fees and avoiding market timing and security selection.

Swensen points out that one of the advantages of this approach is that it enforces a discipline of buying high and selling low. Although the return on bonds is lower than stocks (over the long term), rebalancing results in moving money from bonds to stocks when stocks are low and the other way when stocks are high.

He cites studies that indicate that you can attain the benefits of index funds (and almost completely avoid fees) by owning a diversified portfolio of individual stocks. However, a portfolio with only 20 different stocks is not enough, 50 is required to be effectively diversified. Unfortunately, he does not directly address how to get from a position of owning 20 stocks with low basis value to a fully diversified portfolio.

One important observation is that fact that the often quoted 8-10% return on U.S. stocks since the 1920's and the similar return since 1800, is an aberration, unmatched in any other stock market worldwide. In fact, almost all have gone through at least one period of such disruption (war,...) that almost everything was lost. The worldwide long term rate of return is about 0.8%. Buy some bonds.

His attack on the REIT fees (16%!) and on Wells (basically a criminal organization) in particular was very persuasive. Once again, Vanguard to the rescue. His recommendation of U.S. Treasury Bonds, even the TIPS, was less persuasive to me. His analysis of the effect of inflation on equities and bonds missed the key element of timing; although stocks may be a long term hedge against inflation, the intermediate impact of inflation is to motivate governments to raise interest rates, thereby making bonds more attractive than equities. Witness the late 1970's.

He makes brief but important references to what one might think of as one's extended portfolio. For instance, if you own your own house, that could substitute for an investment in REITs. Similarly, if one anticipates inheriting a substantial sum in bonds, that should be considered as part of the asset mix of the portfolio.

Swensen's preference for Treasury bonds over corporate bonds and munis is less persuasive to me. He identifies several disadvantages of corporate bonds and munis, but doesn't demonstrate that the higher interest isn't worth the higher potential for default, risk of reduced rating, and callability of these securities. However, he certainly makes it clear that simply comparing after tax returns is insufficient to make the choice. Callability in particular substantially reduces the value of munis.

One final bone to pick with Swensen's strategy is the long term impact of asset class balancing. Although in the short term the practice of selling assets that have risen in value to buy those that have not will enforce

buying low and selling high, over the long term this will result in a continuous flow of funds from asset classes with a higher expected return (equities) to those with lower (bonds). I remain conflicted about the role that bonds should play in my own portfolio.

Yofish says

By the guy who runs Yale's endowment fund. Talks about how individuals should not invest their money. Makes a lot of interesting points, but is a bit argumentative, and not very understanding about trade-offs between spending all your time worrying about it, and paying others to take care of things. Doesn't do a very good job of saying what you *should* do. Not a great writer--a bit repetitive. Doesn't come across (to me) as one being objective about presenting his numbers. I will change my thinking in investing, at least some.

Jeff says

Sitting on a board for a private foundation, I have heard the name David Swensen mentioned over and over from our investment advisors. Swensen is the Chief Investment Officer for Yale University and has attracted the attention of the investment world for his stellar results in that position. His 2000 book, Pioneering Portfolio Management, is a classic guide for foundation portfolio management. When I learned that a revised version of Pioneering Portfolio Management was being written and scheduled to be released in early in 2009, I decided to read his book for personal investment that was published just three years ago. I started this book in mid-September, when things look shaky on the Dow but hadnâ€™t yet gotten down-right depressing. As I read, the market started to react erratic and I, along with everyone else, saw investments drop like lead sinkers. Iâ€™ve wondered what Swensen would say about the current turmoil in the market, but I feel he would stand by much of what heâ€™s written.

Unconventional Success is not an â€œinvestment how-to book.â€• There are no â€œstock tipsâ€• here, only warnings. Thereâ€™s no discussion on building a portfolio or any of those silly charts as to what might happen if we place a hypothetical $100 a month into investments for 40 years. Instead, Swensen takes a more academic approach. The first two parts of the book (roughly the first half) deals with investment theory. Swensen covers asset allocation and market timing. This section was well written and explores the various options for investing and provides a good introduction into the various forms of securities available. Swensen, like most investment gurus, is in favor of well diversified portfolios, where each asset class is large enough to matter but small enough that it mitigates risk. He illustrates a well diversified portfolio with the following targets:

Domestic equity.....30%
Foreign Developed equity 15%
Emerging Market equity..... 5%
Real Estate 20%
U.S. Treasury Bonds.....15%
US TIPS.....15%

Swensen prefers bonds back by the federal government and stays away from corporate bonds and foreign debt. Corporate paper limits oneâ€™s potential gain. If interest rates fall, corporations can refinance, calling the higher interest bonds and reissuing lower interest bonds, if rates rise, youâ€™re stuck with a lower interest rates. Foreign debt is often risky, especially in countries where the government is shaky. Swensen splits his fixed assets between regular treasury bonds and Tips (Inflation protected bonds). There are some

REITS (real estate investment trusts) that he likes for real estate investment component, but heâ€™s also critical of many of them due to their fee structures. He sees REITS as long-term investments (and certainly those who have invested in REITS several years ago will have to take a real long term outlook before they can recoup their investment).

Swensen also sees stocks as a long term investment, although he warns not to be too sentimental over particular companies that you want sell when you need to rebalance. He realizes that most individuals have a hard time investing in individual companies. Traditionally, the rule has been it takes at least 30 different stocks, diversified in various sectors of the economy, to reduce risk. Swensen suggests it may even require 50 different stocks and agrees that the average individual doesnâ€™t have time to make such selections. The alternative, the Mutual Fund Industry, is also flawed and Swensen attacks the industry throughout this book. Heâ€™s especially hard on mutual funds that are publically held, seeing a conflict of interest between the fundâ€™s shareholders and the fundâ€™s investors. He examines the various fee structures for funds and is critical of the ways theyâ€™ve developed hidden fees to transfer value from the investor to the fund managers and owners. He explores taxes on mutual funds and how when someone else sells their portion of the fund, it creates tax liabilities for all the fund owners. In the whole mutual fund industry, he only identifies three funds favorably. TIAA-CREF (Teachers Insurance and Annuity Association and College Retirement Equities Fund) is a non-profit fund set up for educators. Swensen does admit a conflict of interest with his approval of TIAA-CREF (heâ€™s on their board). He has mostly favorable things to say about Vanguard Funds (it's non-profit) and a Longleaf Partners, a small fund that's mostly closed to new investors. Over all, Swensen prefers index funds (lower fees and lower turn-over of stocks which means less taxes). He also suggests there are some benefits for ETFS (Exchange Traded Funds), but admits that there is already signs of companies marketing EFTS with unfair fee structures.

Swensen warns against the practice of active management funds which try to beat the market, acknowledging that for every win, someone has to lose. Instead of trying to beat the market, he advocates maintaining a close what on ones asset allocations and frequently rebalancing. Yaleâ€™s foundation rebalances daily (which he admits is not possible for the individual investor). If the equity market rises, they sell and move it into fixed income. If the markets are down, they bring more money into equities. Such a strategy has enabled Yale to comfortably out perform the market in the long run, while avoiding the extreme highs and lows.

This book has political implication. He suggests that schemes like privatizing social security would be a windfall for the mutual fund industry and would not serve the individual investor. This industry has already received a windfall in most companies shifting from a defined pension plan to a self-directed plan, such as with the 401/403 programs. As an investment guru, he is highly attuned to investment schemes where the fundâ€™s interest is not always aligned with the investor (such as mutual fund companies wooing companies for 401 accounts). Furthermore, heâ€™s also critical of companies like Morningstar, thatâ€™s supposed to provide non-biased ratings of funds but often fail to serve the public. (Although he doesnâ€™t address this, this critique seems right on in our recent market turmoil, where bonds had high ratings but were stuffed with subprime mortgages).

I donâ€™t recommend this book if you are looking to start investing. But if you want a deeper understanding of the investment industry, I would recommend this book. He seems to go overboard selling the idea that he mutual fund industry fails to serve the individual investor. Reading all the details of tax implications (which if youâ€™re in an IRA or 401/403 you donâ€™t have to worry about) and of fees (which gets us all), is tiring, but also enlightening. I look forward to reading his updated Pioneer Portfolio Management when it comes out in January.

Jeremy Mitchell says

The first half of the book was great for asset allocation tips, clearly delineating various asset classes as to risk exposure and historical return characteristics. The second half quickly descended into a rant against the mutual fund industry. While some points here had validity, Swensen continuously engaged in quite a bit of vitriol and sarcastic commentary following his more academic reporting of his and other's MF analyses--quite unprofessional.

There are a few items of reasoning that did not seem to make sense. For example, one of his premises is that fund size (Assets Under Management) is the enemy of performance. One might reasonably assume that this would apply only to actively managed funds and not to index funds for obvious reasons. However, my experience has been that generally the greater assets under management accumulated by a mutual fund, the greater the difficulty in deploying those funds effectively, and thus the outlet is to buy large cap companies, which in turn realistically would engender a more index-like return (minus fees and expenses, of course). Let's then look at the contrary, or a smaller fund size. His argument in the book is that security selection is almost always a detriment to portfolio performance, as Swensen claims that managers cannot consistently select companies that will outperform the market at large. Thus, it would seem that the smaller the fund size, the more concentrated bets the manager would be able to make, and thus the likelihood of below average returns would increase. this does not even take into account the lack of economies of scale for administrative and trading expenses forgone by small fund size. So, there is a bit of an apparent contradiction of premises among a few of the arguments presented. One of the most interesting facets is a chapter entitled "Winning the Active Management Game", which does nothing but provide a case-in-point example of a fund management company doing it "the right way". Coincidentally, the funds performances are quite good, beating the associated benchmarks by hundreds of basis points over 10 and 20 year time-frames. I'm wondering a) how much did Swensen get paid to sell this fund manager in his book, and b) why select a fund company that both does it the right way and vastly outperform, if your agenda is to bash mutual funds and active management? Not only does Swensen bash active security selection, he also bashes active asset allocation, preferring that investors take historical returns and risk profiles of various asset classes as a strong indication of future dynamics. A prime example of how this will absolutely NOT be true are Fixed Income. As one may know, bond prices move inversely to prevailing interest rates; further, interest rates have just completed the greatest plummet in market history, with 10 year treasury yields falling from 14.5 in the 1980s to a measily 2.8% today, with a long term average of 4.6% and a median of 3.8%. It would be patently foolish to believe that total returns on bonds will be anywhere near what they have been during this 30-year time-frame.

The dichotomy continues for anyone familiar with Swensen's annual yale endowment reports, where he constantly credits "superior active management" to the fund's excess returns over market benchmarks. For one that does not believe in active management, he and his cohort at the Yale Endowment appear to be doing a fine job of "actively managing" their funds.

The takeaway invariably is that asset allocation and asset class risk exposure matter, and that Swensen would recommend low-cost index funds or well-constructed ETF vehicles for market exposure. Ultimately, I don't believe one will go wrong following this advice--especially on the asset allocation and selection basis--but I do believe that using superior managers, whether through mutual fund vehicles or not, may provide better risk adjusted returns than their index counterparts.

I recommend the individual investor read the first half of the book, glean some asset allocation advice from a superior endowment manager, and leave the second-half for the birds.

Benjamin says

This is an incredibly interesting book written in an incredibly dry style. Besides including lots of practical investing advice, it deftly justifies the stance that the vast majority of investors cannot beat the market, and (less important, but more fun) skewers the investment industry.

An example of the practical advice is the observation that stocks are a hedge against inflation, albeit one with a lot of volatility and noise. Inflation, on the other hand, harms bonds.

It's not enough to beat market, but rather one must beat market by a wide enough margin to overcome the additional costs of active management. Moreover, the financial industry's goals are diametrically opposed to investors: the more a fund manager charges, the more they make and the less the investor does. As the money under their management increases, they earn far more from the base fees than from any performance-based bonuses. (As an aside, in Chapter 4, Swensen argues that investment firms purposefully obscure the distinction between making the bonus a percent of profit versus a percent of the profit above market returns. By structuring their fees in terms of the former, the firm is effectively getting a free ride for market performance, something which they have no control over).

This last point is directly related to the one thing I wish would have been explicitly explained. Swensen makes repeated reference to the fact that increasing a fund's assets too much reduces the return. I can, after the fact, make up reasons why this might be so, but, if I am honest, it is more intuitive that the opposite be true.

In Swensen's discussion of different asset classes, he always includes a section devoted to alignment of interests between the investor and the manager of the assets. For example, he argues that stock investors and corporate management have roughly the same interest. Barring some notable exceptions, both parties do well when stock value increases.

In the section on bonds, Swensen carefully spells out that increasing interest rates decreases bond value (since the old bonds are, relative to bonds at the new rate, are less attractive); this is a point that is consistently misreported. He also carefully spells out how a bond investor's risk corresponds to their time horizon. If a short-term investor buys long-term bonds, the fluctuations described at the beginning of the paragraph introduce risk when it comes time to sell them; conversely, a long-term investor buys short-term bonds, they must buy them many times over the course of the investment, which means they must buy repeatedly under variable terms that depend on the current interest rate.

Chapter 5 has a scathing analysis of the advertising and misinformation surrounding a Charles Schwab account (there are other case analyses; I like this one because it specifically addresses what diversification should look like). He takes them to task for following trends and changing their advertising language depending on how the market as a whole is doing. By following bull markets, they are chasing gains at the cost of diversification, despite any pretense to the contrary.

Swensen is also scathing in his discussion of asset-backed securities, of which the most common are mortgage-backed securities. The book was written in 2005. At a high level, his analysis focuses on how complex this financial instrument is, which he argues is usually a sign that the high-powered engineers of such assets will gain at the expense of the investor. More concretely, he argues that the ability for these loans to be paid off early means that they are not a good substitute for government bonds, and that the pricing is too complex for an investor to tell if they are being adequately compensated for this fact.

In Chapter 8, he takes the Russell indices to task. He spoke ill of them a number of times earlier in the book, but it is here that he carefully dissects their defects. This is primarily a good reminder that one cannot blindly

trust that one is being sold what one is promised (this is worrisome for the lazy investor who will follow Swensen's advice to use passively managed funds; care must be still be taken). The Russell example also serves as yet another of Swensen's dry jabs at the financial industry. He never explicitly addresses why such a poorly constructed index continues to exist, but it doesn't take a large mental leap to assume that it serves as a very useful (from the standpoint of investment firms) benchmark that is easy to outperform (which in turn pads the performance-based fees).

Chapter 9 is little more than a long list of mechanisms by which investment firms have historically taken advantage of individual investors.

my favorite quote: "As legislators and regulators reacted belatedly and ineffectively, the game changed, but the outcome remained the same. Big shots won. The little guy lost."

Matt Krueger says

Recommended for anyone seeking asset allocation advice for personal investments. This book is long winded at times and is showing its age, but the fundamental message it portrays is still sound.

Karsten W. says

Swensen argues that there are basically three sources of returns: asset allocation (which market(s) do you choose? Bonds, stocks, real estate?), market timing (when to sell and when to buy) and security selection (after you chose your market(s), which stocks, bonds, etc. do you pick?). The book is structured by this argument.

I skipped large portions of the book as I realized that I want to look at different markets as Swensen. I am more interested in the token economy than the "core asset classes" he suggests, also his critique on mutual funds was not interesting to me because I do not plan to invest there.

However, I liked the way Swensen substantiates his claims. His book has some careful selected and compiled tables that actually show that his points are not some sort of gut feeling. That is something I did not see that often in Personal Finance literature.

What I remember from this book is: Market Timing is hard. Portfolio Rebalancing (for example, pick ten stocks with the highest estimated Sharpe ratio on regular intervals) may work, performance chasing most likely not. At least my investment strategy should benchmark against a strategy that does very little market timing.

Jon says

A great read for the individual investor, whose career is outside financial services (and even those inside). Detailed, comprehensive, and sensible.

Song says

The author may be a good fund manager and an experienced investor. The book was written poorly. He loved to use the academic language, such as very long sentences, indirect descriptions and iteration of the same meaning for many times. The book is not attractive for reading. It's hard for me to follow the author's ideas and I lost my patience in some chapters when the author dedicated a few pages to repeat one same idea back and forth.

It's not a total waste to read the book though because the author really had the insights about asset management and fund investment pitfalls to avoid. But the book is really dry to read and difficult to comprehend.

Stefan Bruun says

A surprisingly qualitative introduction to diversification in an investment portfolio as well as a structured assessment of pros and cons of various investment products.

I would personally have liked a presentation based more on data and less on anecdotes.

Krenzel says

"Unconventional Success: A Fundamental Approach to Personal Investment," written by David Swensen, who has had great results as the chief investment officer of Yale University, puts forth a simple premise for investors: that they do the best when they construct portfolios that are equity-oriented, broadly diversified, and managed by not-profit companies (Vanguard and TIAA-CREF). Probably, most of Swensen’s readers already understand this unconventional wisdom, but for the 90% of others still getting ripped off by mutual fund companies and brokers, unfortunately they aren’t likely to read this book and, because the book reads like a college textbook, even if they started reading it they wouldn’t be likely to finish. Still, while Swensen’s book has a well-worn thesis, it provides some valuable insights for investors looking to craft a passive investment strategy.

The most interesting part of Swensen’s book is his discussion of six core assets everyone should own: domestic equity, foreign developed equity, emerging market equity, real estate, U.S. Treasury bonds, and Treasury Inflation-Protected Securities (TIPS). Using an equity orientation and the rule of diversification – that no asset class should comprise more than 30 percent of the portfolio – Swensen suggests a generic portfolio including 30 percent domestic equity, 15 percent foreign developed equity, 5 percent emerging market equity, 20 percent real estate, and 15 percent each of U.S. Treasury bonds and TIPS. While this allocation is actually pretty conventional based on what I have read in other passive investing books, "Unconventional Success" includes the best explanation of REITs as a core asset class that I have read. Basically, he says they add diversification by incorporating both bond-like elements, as real estate companies collect rent payments, and stock-like elements, as real estate prices climb or fall like the stock market. While I would not be comfortable with the 20 percent allocation included in Swensen’s generic portfolio, he is also careful to point out that personal preferences play a critical role in portfolio construction, as investors will only stick to portfolios they understand and are comfortable with, so I don’t feel quite as bad about not

having a large allocation of REITS.

Swensen's generic portfolio is also interesting for the asset classes he leaves out, including corporate bonds and foreign bonds, which are usually included in investing books as a good source of diversification. According to Swensen, corporate bonds provide no useful diversification benefit and investors should be wary that their interests – getting high returns – are not aligned with corporations' interests in selling the bonds, as companies are trying to secure financing at the lowest price possible. Discussing foreign bonds, Swensen says that investors get sufficient foreign exchange exposure through owning foreign equity and finds that these bonds are not useful diversification tools for investors. The other thing I found interesting is that Swensen leaves mutual funds with a value tilt out of his core asset classes, but he never discusses why or even mentions value funds. I have read elsewhere that, by keeping each fund at less than 30 percent of the total allocation, he is staying away from overweighting, so a value tilt isn't as important, but I would be interested in reading more from Swensen on this topic, as William Bernstein, another very credible investing guru, seems to strongly advocate going with a value tilt. In any case, while I believe I will stick to a value tilt, I found Swensen's arguments against corporate and foreign bonds very convincing and incentive enough to leave Vanguard's Total Bond Market Fund and instead go with the individual Treasury and TIPS funds.

One other strong point included in "Unconventional Success" typically appears in other passive investing books, but Swensen's arguments for rebalancing are particularly well stated. Swensen says the most frequent form of market timing occurs in the form of investors failing to rebalance, which results in overweighting recent strong performers and underweighting recent weak performers. Because asset classes tend to revert to the mean, it is best to have a systematic rebalancing plan in place to avoid this indirect form of market timing. Prior to reading this book, I knew I was supposed to rebalance but hadn't been as rigid about it as I should be.

Overall, "Unconventional Success" is a tough book to get through, but in the end it is a worthwhile read. While readers may get tired of the endless examples of failings on the part of the mutual fund industry, and may already have come to the conclusion that passive indexing with Vanguard is the way to go, "Unconventional Success" is successful in advancing the idea that there is a conflict of interest between mutual fund companies, who seek high fees, and investors, who seek low costs. In the end, this idea doesn't just apply to your investment strategy (active vs. passive), but which company you invest with, and what types of asset classes you are investing in. It is not enough to just invest with an index fund or invest with Vanguard, because even index funds can charge high fees and even Vanguard has shortcomings. While the author may get redundant, he succeeds in driving home this point home that, as investors, we have to be careful to ensure we are investing in assets and companies that align with our own interests, and the best way to do this is with not-for-profit organizations in certain core asset classes.

Jason Dang says

Pretty long, drawn-out, and dated. Much respect to the author who is one of the best modern-day investors but I feel this book was better articulated in say John Bogles Common Sense on Mutual Funds. I suppose if one is really detail oriented and theoretical, this would be a great book but in that case, he has a more quantitative book 'Pioneering Portfolio Management' which seems to receive rave reviews. This book was designed for the mass market but even as a financial hobbyist (this is waning given my realization that to manage sums of less than 8 figures, you can (and should use) lazy portfolios (and this book seems to advocate that as well). The portfolio posited in this book backtests really well and is theoretically sound (backed by the few hundred pages in this book).

US equity: 30%
Foreign developed equity: 15%
Emerging market equity: 5%
US REITS: 20%
US Treasury bonds: 15%
US TIPS: 15%

He did host a guest lecture at Yale which is definitely worth listening to...

Jordi Costa says

Your basic investment primer

Kirk G. Meyer says

An eye opening book

This book serves as an excellent tool to the world of investing in mutual funds. Written in plain English so that anyone who is interested in investing can understand what the author is saying. It also exposes the mutual fund business as one in which the investor is behind the eight ball so to speak. But it is a valuable reference for the average investor in today fund driven world.

Rtwfroody says

There's a lot of good information here, but the writing is not very engaging. I found it a tough slog, but I learned some important things.

Read something like Bernstein's Four Pillars first. It's much more approachable and covers a lot of the same ground.
