



April 20, 2008

Your Money

Yale's Money Guru Shares Wisdom with Masses

by Chris Arnold

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Chris Arnold, NPR

David Swensen stands on the trading floor at his offices at Yale, where he and his team of 20 analysts work.

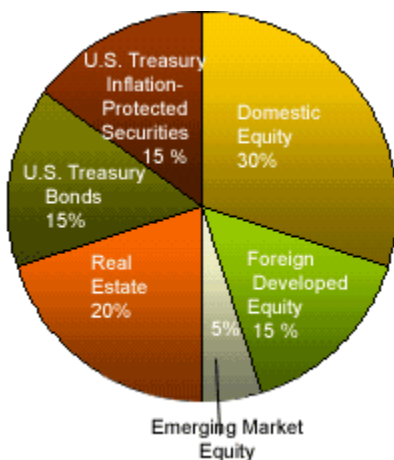
More Tips from Swensen

April 3, 2008

[Yale Money Whiz Shares Tips on Growing a Nest Egg](#)

Where to Put Your Money

The chart below represents Swensen's basic formula for creating an investment portfolio likely to give you good returns while still managing risk:



- **Domestic Equity (30 percent):** Refers to stocks in U.S.-based companies listed on U.S. exchanges.
- **Emerging Market Equity (5 percent):** Refers to stocks from emerging markets around the world, such

All Things Considered, October 5, 2006 · Yale University recently announced a 23 percent return on its investments, swelling its endowment to a whopping \$18 billion. The man behind that investment success is David Swensen, one of the most gifted investors in the world. He's made an average 16 percent annual return over 21 years — better than any portfolio manager at any other university.

Nobody has numbers that good. Not at Harvard, Princeton, Stanford, or any foundation or pension fund; Swensen consistently beats them all. And recently, Swensen has become passionate about trying to teach individual investors how best to save for retirement.

For a long time, universities invested in a plain-vanilla mix of stocks and bonds. Swensen helped change that. He has built a portfolio with stakes in venture capital funds, real-estate partnerships, emerging market stocks and scores of small, specialized investment outfits. Any tiny market movement changes the balance of the whole thing.

So how does Swensen keep track of it all?

"I have a calculator," Swensen says with a chuckle. "And then I talk to one of my colleagues, who executes the trade. So it's decidedly low-tech."

He also has a nice computer with two flat-panel monitors on his desk, which sits in the middle of the small trading floor where he and his team of 20 analysts work. The monitors show the value of Yale's investments by category. Swensen says he could use automated software to help him balance the numbers each day, but that would take all the fun out of it.

The Billion-Dollar Man

Swensen, 52, is an unassuming, affable Midwesterner. He could easily pass for a friendly high-school math teacher or a town pastor. But he makes more money than they do. Yale pays Swensen \$1.3 million a year. That sounds impressive until you realize that, with his track record, if Swensen started his own hedge fund, he could earn \$50 million to \$100 million a year.

But Swensen would rather work for Yale, where he earned a Ph.D. in economics. He spent five years on Wall Street and then, 21 years ago, agreed to return to lead Yale's investment office.

"I had a great time on Wall Street, but it didn't satisfy my soul," he says. "And I've always loved educational institutions. My father was a university professor, my grandfather was a university professor. So there must be something in the genes."

Swensen teaches a course at Yale in which he airs his unorthodox view of the

as Brazil, Russia, India and China.

- **Foreign Developed Equity (15 percent):** Refers to stocks listed on major foreign markets in developed countries, such as the United Kingdom, Germany, France and Japan.
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- **U.S. Treasury Notes and Bonds (15 percent):** These are fixed-interest U.S. government debt securities that mature in more than one year. Notes and bonds pay interest semi-annually. The income is only taxed at the federal level.
- **U.S. Treasury Inflation-Protection Securities, or TIPS (15 percent):** These are special types of Treasury notes that offer protection from inflation, as measured by the Consumer Price Index. They pay interest every six months and the principal when the security matures.

basics of a well-diversified portfolio. He argues that, by owning not only stocks and bonds but also holdings in real estate, timber, oil and gas, and other investments, you can get strong returns with less overall risk.

A few years ago, he decided he wanted to spread his message to more people. So he wrote a book, *Unconventional Success*, with advice for the average investor. Swensen warns there's no "one-size-fits-all" approach to investing. But if you want to follow his advice, he shares some basic tips below.

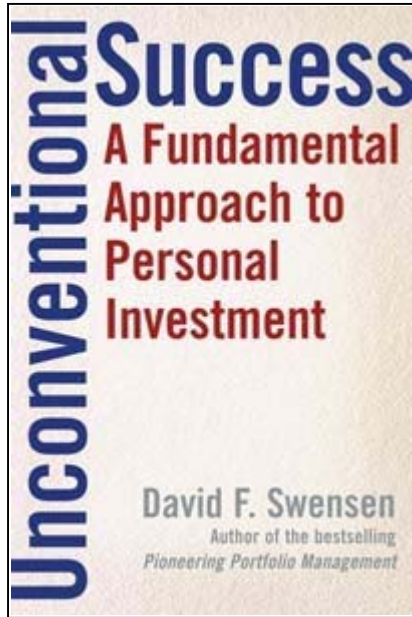
Want More Details?

Vanguard is one of the few major nonprofit mutual-fund families. To help people understand exactly what he's suggesting, Swensen picked a few Vanguard funds to consider. Swensen is in no way affiliated with Vanguard.

- **Domestic Equity:** Vanguard Total Stock Market Index Fund (VTSMX)
- **Foreign Equity:** Vanguard Total International Stock Index Fund (VGTSX)
- **Emerging Markets:** Vanguard Emerging Markets Stock Index Fund (VEIEX)
- **REITs:** Vanguard REIT Index Fund (VGSIX)
- **Government Bonds:**
 - Vanguard Short-Term Treasury Fund (VFISX)
 - Vanguard Intermediate-Term Treasury Fund (VFITX)
 - Vanguard Long-Term Treasury Fund (VUSTX)
- **TIPs:**
 - Vanguard Inflation-Protected Securities Fund (VIPSX)

Scroll down for more investing tips from Swensen.

Your Money

David Swensen's Advice for the Individual Investor

Swensen shares more investing advice in his book *Unconventional Success*.

Beware of the Mutual Fund

Myth: Many Americans seem to like the idea of pooling their money in an actively managed mutual fund -- where, presumably, a professional money manager can invest it better than they could themselves.

But Swensen says that doesn't work. He says for-profit mutual funds have an inherent conflict of interest. They make money by charging fees that suck profits away from investors in the funds. In fact, over time -- when you factor in the fees, taxes and other costs -- he says *your odds of beating the market in an*

actively managed fund are less than one in 100.

Most mutual funds get far too big and own far too many stocks, Swensen says. In *Unconventional Success*, he writes that, when a fund is holding 30 to 50 stocks or more, the odds become very likely that the fund will start to track its broader market category. Stock picking becomes less important as the winners and losers in the fund average out much like the broader market. So why pay someone a lot of money to pick stocks?

He says mutual fund investors also lose from commissions and market impact associated with all the churn -- that is, the buying and selling of stocks in the fund.

Invest in Nonprofit Index Funds: Since at least 99 percent of mutual funds aren't going to beat the overall market, Swensen says individuals should invest in nonprofit funds that track market segments, such as the S&P 500. There are a range of index funds that track the U.S. domestic stock market, international markets, emerging markets and the real-estate market.

Swensen says mutual funds that are organized on a not-for-profit basis don't have the same conflict of interest as for-profit funds, and they charge lower fees.

The fees are even lower with nonprofit *index* funds, because you're not paying money managers to research stocks and buy and sell them. The fund simply holds all the stocks listed in that index. And because well-structured index funds have low churn (turnover), they are remarkably tax efficient.

Pick the Right Investment Mix and Keep Your Money

There. Don't Move It Around! Swensen says that individual investors will make the greatest return by focusing on the right way to carve up their portfolio into different areas of investment (see the pie chart at top left). He says they should then stick with that mix.

Don't, for example, try to decide when to buy U.S. stocks and sell a lot of bonds, in an effort to predict which way those markets are heading. If you do that, he says, you're going to lose over time, because you'll be competing directly with professionals like him.

Swensen has a team of 20 analysts -- and a small army of boutique investment houses -- working long hours to predict which way certain market segments or individual stocks will move. Who do you think is going to buy and sell at the right time? Remember: If somebody buys low and sells high, somebody else is buying high from them. You don't want to be that person.

Rebalance Your Portfolio: Swensen rebalances his portfolio at Yale at least every day, and often many times throughout the day. What does that mean?

Let's say U.S. stocks go up 2 percent one afternoon, while international stocks decline by 1 percent. If you have holdings in both areas, the percentage of your portfolio that's in U.S. stocks has grown a bit, and the foreign-equity portion has shrunk a little. Over time, this process can really change the face of your portfolio -- especially if you continue to reinvest your earnings, or make contributions to a 401k or 403b, without ever rebalancing.

So, Swensen says, you need to regularly rebalance your holdings to keep them steady. That way, when the value of foreign stocks or emerging-market stocks rises, you'll own more of them -- and will make more money -- if you rebalanced while these stocks were cheaper.

Adjust Your Portfolio as You Near Retirement: As you get older and closer to retirement, it's obviously important to have enough money in less risky, more predictable investments.

But rather than changing all the numbers on your "asset allocation" pie chart depending on your age, Swensen prefers to think about this question in a way that's easier to grasp. He says as people age, they can keep their investment portfolio set up the way it always has been. But they should start to move money out of it, across all investment categories proportionally, and transfer the money into an account that's invested in money-market funds or short-term, inflation-indexed bonds.

-- *Chris Arnold*

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David Swensen stands on the trading floor at his offices at Yale in a file photo.

Morning Edition, April 3, 2008 · The turmoil in the stock market has a lot of people nervous about their retirement savings. If only they had David Swensen investing their money.

Swensen manages Yale University's endowment. Last year, he made a 28 percent return, adding a whopping \$5 billion to Yale's endowment, which is now valued at \$22 billion. And that wasn't a fluke: Over the past two decades, under Swensen's watch, Yale's endowment has grown an average of 16.8 percent a year, more than any university, foundation or pension fund.

In scary economic times like this, he cautions that individual investors shouldn't trust their instincts.

"The human tendency in this kind of environment is to do something — to make a change," he says.

More Tips from Swensen

Oct. 5, 2006

[Yale's Money Guru Shares Wisdom with Masses](#)

Stocks seem risky, especially since they've been falling. Swensen says most people he talks to get nervous and want to sell stocks.

"And that's exactly the wrong reaction," he says. "Buying high and selling low is not a way to make money. It's not hard, right? It's very simple: You want to do the opposite."

Where to Invest Wisely

Yale guru David Swensen uses a basic formula for creating an investment portfolio. He also has suggestions about how to keep the balance in a volatile market. [Read his tips.](#)

Finding the Right Investment Mix

To share the wealth with everyone, Swensen wrote a book about retirement investing that details his allocation strategies. He advises having the right long-term mix of stock index funds, bonds and real estate investment trusts (see chart below).

But when stocks tank, that mix gets out of balance: For example, U.S. stocks that once constituted 30 percent of a portfolio may now constitute just 29 percent or 28 percent.

When that happens, Swensen rebalances, shifting more holdings into stock index funds. Then, if the market comes back up and ends the day flat — where it started — Swensen sells those stock index funds.

Swensen's ability to buy low and sell high on the market roller coaster has in some instances earned upwards of \$1 million in a single day for Yale's endowment — just by rebalancing amidst volatility.

"So you end up at the same place you started, except a million dollars ahead, that's not bad," he says. "But from rebalancing, not speculating — just sticking with your long-term targets."

That's the upside: The stock market can end up flat, but investors still make money because they rebalanced when it was down. Sometimes the market keeps going down. But over time — five, 10 or 20 years — as the market keeps rising, Swensen says, investors can goose out extra returns by rebalancing along the way.

Paying for Investment Advice?

One of the reasons that Swensen can rebalance so frequently is that Yale, like other educational institutions, is tax-exempt. Before attempting to rebalance their portfolios, individual investors need to understand the tax implications of any trades they might make.

Figuring out the right mix of what to own can be tricky. Many people seek out professional advice.

And that's a good idea, says Jim Barnash, the national director of financial planning for Ameriprise Financial. He says in volatile markets like this one, people need quality one-on-one advice to make sure they're properly diversified.

But Ameriprise's advice comes with a price: up to 1.25 percent of the total investment. That means an investor with a half-million dollars invested in a retirement 401K would end up paying about \$6,250 a year in fees.

Over 20 years, that person is losing hundreds of thousands of dollars because of fees. Of course, that's better than not investing at all, and a lot of people want an adviser to help them.

But Swensen says most of these investment services provide pretty mediocre advice, and it's just not worth giving them a percentage of your life savings.

"That's the wrong path," Swensen says. "And the reason it's the wrong path is it's a very, very expensive path."

Index Funds or Mutual Funds?

Swensen says fees are also the big reason you should buy index funds instead of classic mutual funds. Index funds, which track market segments like the S&P 500, are a lot cheaper.

Swensen says the vast majority of professional mutual fund managers fail to beat those indexes.

"When you look at the results on an after-fee, after-tax basis over reasonably long periods of time, there's almost no chance that you end up beating an index fund," he says. The odds, he says, are 100 to 1.

Swensen, who cautions against trying to pick individual stocks, favors nonprofit funds like Vanguard and TIAA-CREF. There too, the lower fees will mean more money in your pocket over time.

Your Money

The Rebalancing Act: Managing Your Investments

by Chris Arnold

Want More Details? Here are some funds from TIAA-CREF and Vanguard that Swensen recommends.

- **Domestic Equity:** Vanguard Total Stock Market Index Fund (VTSMX); TIAA-CREF Instl Equity Index Retail (TINRX)

- **Foreign Equity:** Vanguard Total International Stock Index Fund (VGTSX); TIAA-CREF Instl International Eq Retail (TIERX)

NPR.org, April 2, 2008 · So you've set up your investment portfolio according to the mix recommended by Yale's David Swensen. Now what? Remember to rebalance.

Rebalancing: A Free Bonus

When is it time to rebalance? Swensen says people should rebalance their retirement accounts at least quarterly — four times a year. He says the technique is a disciplined way to

• **Emerging Markets:** Vanguard Emerging Markets Stock Index Fund (VEIEX)

buy low and sell high over time. It also keeps your risk profile where you want it to be.

• **REITs:** Vanguard REIT Index Fund (VGSIX); TIAA-CREF Instl Real Estate Sec Retail (TCREX)

But investors should always try to avoid transaction fees. Even some nonprofits like TIAA-CREF may charge extra trading fees if an investor rebalances more than a certain number of times a year.

• **Government Bonds:**
 – Vanguard Short-Term Treasury Fund (VFISX); TIAA-CREF Inst Short-Term Bond II Retail (TCTRX)
 – Vanguard Intermediate-Term Treasury Fund (VFITX); TIAA-CREF Instl Bond Retail (TIORX)
 – Vanguard Long-Term Treasury Fund (VUSTX)

Swensen rebalances Yale's endowment every day. Yale's endowment has in some instances earned upwards of \$1 million in a single day — just by rebalancing. Individual investors won't make that much, but it shows the power of rebalancing. Even if the overall stock market doesn't show a gain, you can goose out extra returns this way.

• **TIPs:**
 – Vanguard Inflation-Protected Securities Fund (VIPSX); TIAA-CREF Instl Inflation Link Bd Retail (TCILX)

Timing Is Everything

..... Here's how it works: Let's say an investor has allocated their investments according to Swensen's basic formula (30 percent in U.S. stocks, 30 percent bonds, 20 percent real estate investment trusts, etc.) and the U.S. stock market falls over a couple of months. With U.S. stocks falling, stocks may now make up only 28 percent or 29 percent of the 401K pie chart.

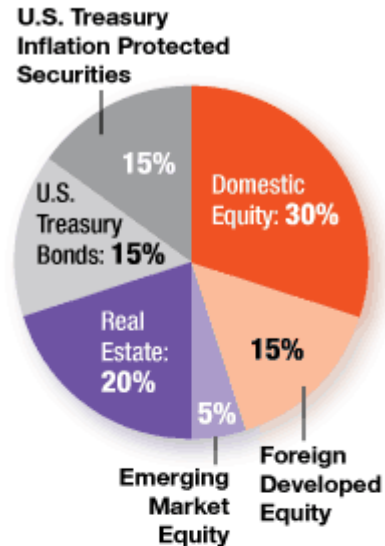
But perhaps bond holdings have risen over the same time period, from the target 30 percent to 31 percent or 32 percent. Then it's time to rebalance by selling some shares in the bond funds and using the proceeds to buy more stock index funds, bringing both categories back into line with long-term allocation targets.

If stocks come roaring back in a month, an investor would own more stocks and make more money on the gains. If stocks jump up to 31 percent or 32 percent in the model portfolio, then an investor would sell stocks high and buy something else — real estate, bonds or whatever has decreased its share of the 401K.

The Tax Factor

Where to Put Your Money

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- **U.S. Treasury Inflation-Protection Securities, or TIPS (15 percent):**

These are special types of Treasury notes that offer protection from inflation, as measured by the Consumer Price

Swensen can rebalance Yale's endowment frequently because Yale is tax-exempt. But if an individual invests savings outside of a 401K or other tax-deferred account, he or she needs to be aware that rebalancing can create tax liabilities. One way to avoid that is to do rebalancing only in the tax-deferred portion of a portfolio. New contributions may also be used as rebalancing tools, so that investors sell fewer existing investments.

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