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Research questioned

To the Editor: The Portfolio Insurance Puzzle (*Pensions & Investment Age*, Aug. 22) by Bruce Jacobs of Prudential Life Insurance Co. concludes its first paragraph with the sentence: My research indicates, however, that these (portfolio insurance) techniques substantially reduce returns in the long run.

Since our research demonstrates precisely the opposite is true, I wondered what research Mr. Jacobs had done that had uncovered this well-hidden fatal flaw.

According to the article, Mr. Jacobs reached this conclusion on the basis of three performance comparisons. One of the three (Standard & Poor's 500 vs. insured S&P 500, 10 years ending 1982) is quickly dismissed by Mr. Jacobs as unrepresentative because stocks exhibited their risk (rather than their expected return) during this period, thus biasing the period in favor of portfolio insurance techniques.

The remaining two comparisons, for some unexplained reason, relate to a single period: the 55 years from Jan. 1, 1928, through Dec. 31, 1982. The article states that Mr.

Jacobs' research disclosed that \$1 invested in a Standard & Poor's 500 index portfolio would have multiplied 100-fold during that period.

The insurance policy he chose to compare against this heady investment alternative would protect the portfolio, year-by-year, for 55 years, to a loss no greater than 5%.

Comparing something with potential for near total loss with something that can lose no more than 5% in any year seems a little one-sided. You may feel the use of the phrase near total loss is a bit dramatic. However, an investor who, in August of 1929, had adopted Mr. Jacobs' 100% invested in stocks at all times policy would have found himself with 17 cents on the dollar in June of 1932. I wonder if he would have known how rich he would be if only he would hold on for 50 more years?

On three subsequent occasions, our iron-willed investor would have experienced setbacks of 50%, 29% and, as recently as 1973-74, of 43%.

Further, the particular techniques chosen by Mr. Jacobs to gen-

erally represent portfolio insurance was itself flawed.

As he points out, the standard-bearer he selected to represent portfolio insurance, for some undisclosed reason failed in 1933 and lost 59% to his comparison portfolio. Most of the shortfall for the selected 55-year period occurred in this one year alone and need not have. LeLand O'Brien Rubinstein's Dynamic Asset Allocation Strategy was not used by Mr. Jacobs.

In his final comparison, again confined to the same specific 55-year period, portfolio insurance (with the same flawed implementation) is pitted against what Mr. Jacobs terms an allocated strategy of 61.75% to the S&P 500 and 38.25% to Treasury bills, a rather precise allocation derived with 20/20 hindsight.

According to Mr. Jacobs, the allocated strategy would have the same average protection as that provided by the insured portfolio (emphasis mine). It turns out that employing this precisely allocated strategy provided average protection that included periods with losses of 49%, 31%, 16% and 21%. The

insured strategy, however, never lost in any one year more than 5%.

Fortunately, Mr. Jacobs and the Prudential Life Insurance Co. are not the only researchers into the vitally important emerging field of scientific dynamic investment strategies. Effective Aug. 1, LeLand O Brien Rubinstein Associates Inc.

entered into an argument to provide its Dynamic Asset Allocation Strategy to Aetna Life Insurance Co. for exclusive use in insured contracts.

The thesis, the methodology of research and the conclusion reached by Mr. Jacobs are absolutely wrong. Indeed, his conclusion that the technique reduces long-term gains is pre-

cisely 180 degrees opposite to reality. We would happily debate this contention with Mr. Jacobs.

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