

Boot Camp Presentation #4

Fine-Tuning Your Asset Allocation: The Role of Bonds

In the mid-1990s, our investment advisory firm began encouraging investors to diversify across what eventually became known as the *Ultimate Buy-and-Hold Equity Portfolio*.

At the time, that was not common practice.

Most investors owned:

- The S&P 500
- A total market fund
- Or a handful of actively managed funds

Very few owned meaningful allocations to small-cap value or international small companies.

We believed diversification across *equity asset classes* mattered, not just diversification across companies.

For do-it-yourself investors, we recommended low-cost funds from Vanguard and Fidelity. For privately managed accounts, we used Dimensional Fund Advisors (DFA) Funds. And with each of those portfolios, we built tables. [Fine Tuning Tables 50-50](#) and [Fine Tuning Tables 70-30](#)

Not just tables showing average returns.

But tables showing:

- Worst 3, 6 and 12 month periods
- Worst three and five-year periods
- Volatility
- Risk-adjusted returns

Because investors do not experience averages.

They experience years.

Simplifying Without Surrendering Discipline

When I retired from the advisory business and focused fully on teaching do-it-yourself investors, I continued promoting the 10-fund portfolios.

Then in 2017, Chris Pedersen and John Bogle encouraged us to revisit our implementation.

The question was simple:

Could we make this easier without sacrificing results?

Chris Pedersen, along with Daryl Bahls, went to work. The data showed something powerful: more compact portfolios could match — and sometimes exceed — the long-term results of the original 10-fund structure.

We didn't change the philosophy.

We strengthened it.

From then on, whenever we analyze portfolios — whether for accumulation or retirement — we evaluate them across all nine of our recommended equity portfolios.

Why nine?

Because investors are different.

And somewhere in those combinations, we believe investors can find something essential:

Peace of mind.

That brings us to Boot Camp Presentation #4.

From Growth to Defense

The first three Boot Camp sessions were about growth:

Why stocks beat bonds

Which equity asset classes to own

How to combine them intelligently

This session is about defense.

Because eventually the question changes.

At age 30, volatility is temporary.

At age 70, volatility can threaten current income.

When withdrawals begin, risk feels different.

During accumulation:

Contributions replace some of the losses.

Time allows recovery.

Market declines can be opportunities for buying companies at low prices.

During retirement:

Withdrawals occur during downturns.

Losses compound when money is removed to meet cost of living.

Capital shrinks permanently.

Recovery becomes harder.

This is sequence-of-returns risk.

And bonds are one of the primary tools for managing it.

Starting With a Familiar Base: The S&P 500

Let's begin with the S&P 500 as the equity engine and gradually add bonds.

Long-Term Return vs. Volatility

(S&P 500 + Bonds)

Allocation	Annual Return	Standard Deviation	Worst Year
100% S&P 500	10.2%	17.5%	-37%
80/20	9.4%	14.5%	-29%
60/40	8.6%	11.5%	-20%
40/60	7.5%	8.5%	-13%
20/80	6.2%	5.5%	-7%
100% Bonds	5.0%	4.0%	-3%

The tradeoff is clear:

More bonds

Lower return

Lower volatility

Smaller worst-year losses

The 100% stock investor must tolerate declines near 40%.

The 60/40 investor cuts that nearly in half.

For retirees, that difference can determine whether they stay disciplined — or panic.

The Real Retirement Threat: Multi-Year Losses

Average returns don't ruin retirements.

Timing does.

Worst 5-Year Annualized Returns

(S&P 500 + Bonds)

Allocation	Worst 5-Year Annualized Return
100% Stocks	-4.5%
80/20	-2.8%
60/40	-1.2%
40/60	+0.5%
20/80	+2.2%
100% Bonds	+3.0%

When withdrawals coincide with prolonged downturns, the damage can be permanent.

Bonds improve survivability.

Using a Diversified Equity Foundation

Now let's repeat the exercise using one of our globally diversified 4-fund portfolios.

Long-Term Return vs. Volatility

(4-Fund Equity + Bonds)

Diversification improves expected return.

Allocation	Annual Return	Standard Deviation	Worst Year
100% 4-Fund	11.0%	18.5%	-41%
80/20	10.1%	15.5%	-32%
60/40	9.1%	12.5%	-23%
40/60	7.9%	9.0%	-15%
20/80	6.5%	6.0%	-8%
100% Bonds	5.0%	4.0%	-3%

But diversification alone does not eliminate severe drawdowns.

Only reducing equity exposure reduces drawdowns.

Risk Efficiency: Sharpe and Sortino

The [Sharpe ratio](#) measures return per unit of total volatility— both upside and downside volatility.

Sharpe Ratio

Allocation	S&P Base	4-Fund Base
100% Equity	0.48	0.52
80/20	0.54	0.58
60/40	0.60	0.63
40/60	0.62	0.64
20/80	0.58	0.59

But retirees fear losses, not upside surprises.

That's where the Sortino ratio matters.

Sortino Ratio

Allocation	S&P Base	4-Fund Base
100% Equity	0.62	0.67
80/20	0.72	0.77
60/40	0.82	0.86
40/60	0.88	0.90
20/80	0.84	0.85

Higher Sortino and Sharpe Ratios mean better risk adjusted returns.

4 Fund Portfolio ratios are higher than S&P in both cases.

A Personal Decision

When my wife and I decided to sell our ownership in Merriman Wealth Management, the process took several months.

That gave us time to reflect on everything I had taught for decades.

We knew we had more money than we needed for the rest of our lives.

But we also had commitments:

Funding the Merriman Financial Literacy Program at Western Washington University

Hoping to leave money to our children

Living the rest of our lives without financial anxiety

So our discussion was not about maximizing return.

It was about defining the limit of loss we were willing to accept.

In the end, we chose:

- 50% equities
- 50% fixed income

And within equities:

- 50% U.S.
- 50% international

The result so far has been exactly what we hoped:

- A reasonable return.
- Without anxiety.

After 30 years as an advisor, I came to a simple conclusion:

Most of us are not trying to be the richest people in our community.

What we want is:

Peace of mind — with a reasonable piece of the action.

Your challenge is to figure out what that balance is for you.

And if you can't figure it out, get professional help.

Because the best allocation is not the one with the highest return.

It's the one you can live with.