> *The success of this approach taught me a principle that I apply to all parts of my life: Making a handful of good uncorrelated bets that are balanced and leveraged well is the surest way of having a lot of upside without being exposed to unacceptable downside.* ~ Ray Dalio

Here's an excerpt from a note I wrote earlier this year on portfolio construction.

> The classic macro portfolio is comprised of ever-changing bets and temporary asset allocations that move and shift at the whim of the PM.
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> There's nothing inherently wrong with this approach but I've long thought there's a better way.
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> You see, as traders and investors we're always operating in a kind of "fog of war". We can't see the future. We don't know exactly what's around the corner. And we face two constant risks in general (1) that we'll have too much exposure in a falling market and (2) we won't have enough exposure in a rising market. In addition, fat pitch asymmetric opportunities only come around so often.
>
> Our portfolio construction should reflect this truth. It should be robust to our ignorance and the cyclical nature of big bets and fat pitches.
>
> Jim Leitner, who's one of my all-time favorite macro traders and one of the best money managers most people have never heard of, built his strategy and constructed his portfolio in alignment with these truths. Here's a section from a piece we wrote on Jim a while back (link here).
>
>> *We start off by acknowledging that we are ignorant, so we need to be systematic, clip some coupons, and earn some risk premia. It doesn't matter if it is in currencies, bonds, commodities, real estate, or equities. Of course, we have to be smart about it by reading a lot, talking to smart people, and being on top of it all while acknowledging that we're not that much smarter than the rest of the world.Then, every once in a while, we're going to stumble upon an exciting idea that's going to give us some extra alpha and the ability to outperform.*
>>
>> *After these five main asset categories, we have a last category which we call absolute return.This is where we stick those great, out-of-the-box ideas we come across about twice a year. Sometimes we're lucky and find major mispricings once or twice a year, and sometimes we're unlucky and it takes 18 months before the next one comes along. When we find these fantastic ideas, we're willing to bet up to 10 percent of our fund on one idea. One that we think will double or triple, earning an extra 10 or 20 percent return for the entire portfolio.*
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>> *The absolute return category is there in order to leave us open to making unsystematic money.*

The takeaway from the above is this: Having a beta strategy, an asset mix that delivers stable risk-adjusted real returns as the foundation of your portfolio does a number of things. First, it helps you hedge your ignorance and guard against the two risks we must continuously face of (1) either having either too little risk on or (2) having too much. Secondly, it frees up your mind-space and enables you to focus on uncovering highly asymmetric opportunities.

There are a number of ways one can go about putting together an allocation model. You can build a basket of uncorrelated assets and then apply leverage in a Bridgewater All-Weather type system or you can apply a mix

of fundamental growth and trend following factors to try and keep you in the market when it's good to be in and get you out when, well, you want to be out.

For our purposes, we're going with a kind of cross between the two while keeping things extremely simple, yet effective. Our primary goal is stable low-volatility returns across a long-term horizon and a wide range of market cycles.

Enter The Four Pillar Approach

Our Core allocation will look like the outlay below. Simple, right?

US Large Cap	Stocks	25%
US Small Cap	Stocks	
Foreign Developed	Stocks	
Foreign Emerging	Stocks	
Corporate Bonds	Stocks/Bonds	
T-Bills	Bonds	25%
10 Year Bonds	Bonds	
30 Year Bonds	Bonds	25%
10 Year Foreign Bonds	Bonds	
TIPS	Real Assets	
Commodities	Real Assets	
Gold	Real Assets	25%
REITs	Real Assets	

This mix is actually called the "Permanent Portfolio" and was designed by Harry Browne, an investor and one-time Presidential candidate in the 80s.

Browne gave the portfolio its names because "once you set it up, you never need to rearrange the investment mix — even if your outlook for the future changes. The portfolio should assure that your wealth will survive any event — including an event that would be devastating to any individual element within the portfolio."

The risk-adjusted returns of this portfolio live up to its name. It's one of the most dependable stable asset mixes you can put together. It's produced an average annual nominal return of 8.53% since 1973, experiencing only three down years during that time with the largest annual drawdown being just -6.5%.

These are far from our targeted returns for the portfolio. We obviously want to do much better.

The point of this core allocation is that it is stable across regimes and it's what we'll go to when we flatten out our books whenever we find ourselves in a market where we have little conviction and are not finding attractive trade setups. It solves the two issues of having too much or too little on at the wrong time. It allows us to patiently clip coupons while we wait for highly attractive setups.

Here's how we then build upon this. Three of our four pillars are comprised of the core mix. We have:

1. US Large Cap Equities (S&P e-mini futures or Vanguard's SPX ETF VOO) at 25%

2. US Bonds, with 25% in short-term bills (VGSH) and 25% in long-term bonds (TLT)
3. Gold (Gold futures or IAU) at 25%

We will adjust the sizing of these positions when we have conviction on the direction of the market. For instance, if we're very bullish on gold we can raise the Core position from 25%-50 or 100% and if we're bearish we can flatten it out or go net short. But when we don't have strong directional conviction, we stick with the Core allocation.

Personally, we will use futures for this positioning. The reason is that futures make for much better cash management — you only have to put up a little cash to hold a large notional position.

The fourth pillar is big bets. This is reserved for high conviction thematic trades. These are opportunities where we think we can 5x or more our risk (think DOTM option trades and deep value equity names).

That's it.

Let me know if you have any Qs, comments, or critiques.

Your Macro Operator,

Alex