# Markets in a Minute:
# The Three Little Pigs and Investing

Some of the fables and stories we learned as children and still remember vividly have gotten me thinking about investing and how those stories are still helpful in navigating the volatile and complex world of stocks and bonds. Last time we explored how the Tortoise and the Hare demonstrates the value of consistency and time (spoiler alert: be the Tortoise). So too can three charming little pigs show the importance of a diversified portfolio.

## The House Made of Straw

Too often, investors may be like the First Little Pig: eager to get started, quickly throwing together a house (or portfolio) from whatever is lying around nearby. The First Little Pig was quick and efficient, proud of being the first of his siblings to complete his new abode. But it wasn't long before the Big Bad Wolf arrived, threatening to blow the new house down. Sure enough, with just a little huffing and puffing, down came the rapidly built house.

The straw approach to portfolio building can be tempting. After all, who wouldn't want to grow their investments overnight? Why can't we just buy some Bitcoin and retire? The challenge is that the faster a house or portfolio goes up, often the easier it is to come down. And there is always a Big, Bad Wolf lurking around the corner.

In 2021, for instance, Bitcoin rose by 66%. During that year, the number of users of crypto-exchange apps doubled. But the following year, Bitcoin dropped by 65%. For anyone who had held for those two years, they would have lost over 40% of their investment. In fact, one study suggests that "around three-quarters of users have lost money on their Bitcoin investments."

With his straw house blown down, the First Little Pig couldn't double down and simply build another house - he had been wiped out with no choice but to take refuge at his sister's place.

## The House Made of Twigs

Just as some investors seek the quick path to riches, others prefer to hide and avoid any losses, much like the Second Little Pig. Keenly aware of the Big, Bad Wolf's destructive power, she had tightly bound her twigs together and kept the house small, with wads of cash stuck under her little mattress. She wasn't going to take the risk of a flimsily built structure. Alone in her twig house, the Second Little Pig slept easily, even after her homeless brother arrived.

Then the Big, Bad Wolf showed up. But this time, the Wolf didn't huff and puff. He simply waited. As time ticked by, those carefully stored wads of cash became less valuable, and the Second Little Pig's sense of security dwindled away.

Taking too little risk can be just as detrimental to a portfolio as taking too much risk. For instance, in the US, from 1900 to 2021, inflation averaged about 2% per year, a modest-sounding amount. But compound that rate year after year, and that bucket of cash would have lost 97% of its buying power.

Keeping your hard-earned money in cash means that you won't suffer the big drawdowns that a bear market can bring, but it pretty much guarantees that your assets will lose value over time.

## The House Made of Bricks

No surprise that the First and Second Little Pigs eventually ended up at their brother's place. His house had taken so long to put up that he was just putting the finishing touches on it when they arrived. He had carefully selected his materials with small amounts of straw and twigs interspersed with his hefty bricks to form a commanding structure. It was the very diversity of materials that allowed the house to stand even as the Big, Bad Wolf howled outside.

If you've read articles published by the financial industry, including here, you've probably seen something to the effect of "past performance does not guarantee future returns." In looking at the annual performance of various asset classes, it becomes clear that rarely is one asset class in the top slot from one year to the next. The figure on the next page is often called the "quilt chart" because it looks much like a grandmother's blanket crafted from a variety of fabric scraps.

In 2008, for instance, fixed income outperformed other asset classes as the global financial crisis drove large cap stocks down 37% and emerging market equities down over 50%. The following year, however, results were almost the complete opposite as stocks soared – with emerging market equities up almost 80% – while fixed income lagged, rising a mere 6%.

The unsung hero of the quilt chart is the white box showing a diversified portfolio, the investment equivalent of a brick house, bumping along in the middle – never first, never last. After a fifteen-year period, the diversified portfolio earned an impressive 6% return, despite two bear markets, and importantly did so with one of the lowest levels of risk.

Quilt Chart: Asset Class Returns by Year, Ranked

| 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | YTD | 2008 - 2022 Ann. | 2008 - 2022 Vol. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Fixed Income 5.2% | EM Equity 79.0% | REITs 27.9% | REITs 8.3% | REITs 19.7% | Small Cap 38.8% | REITs 28.0% | REITs 2.8% | Small Cap 21.3% | EM Equity 37.8% | Cash 1.8% | Large Cap 31.5% | Small Cap 20.0% | REITs 41.3% | Comdty. 16.1% | DM Equity 8.6% | Large Cap 8.8% | REITs 23.4% |
| Cash 1.8% | High Yield 59.4% | Small Cap 26.9% | Fixed Income 7.8% | High Yield 19.6% | Large Cap 32.4% | Large Cap 13.7% | Large Cap 1.4% | High Yield 14.3% | DM Equity 25.6% | Fixed Income 0.0% | REITs 28.7% | EM Equity 18.7% | Large Cap 28.7% | Cash 1.5% | Large Cap 7.5% | Small Cap 7.2% | Small Cap 23.2% |
| Asset Alloc. -25.4% | DM Equity 32.5% | EM Equity 19.2% | High Yield 3.1% | EM Equity 18.6% | DM Equity 23.3% | Fixed Income 6.0% | Fixed Income 0.5% | Large Cap 12.0% | Large Cap 21.8% | REITs -4.0% | Small Cap 25.5% | Large Cap 18.4% | Comdty. 27.1% | High Yield -12.7% | Asset Alloc. 4.3% | REITs 6.6% | EM Equity 23.0% |
| High Yield -26.9% | REITs 28.0% | Comdty. 16.8% | Large Cap 2.1% | DM Equity 17.9% | Asset Alloc. 14.9% | Asset Alloc. 5.2% | Cash 0.0% | Comdty. 11.8% | Small Cap 14.6% | High Yield -4.1% | DM Equity 22.7% | Asset Alloc. 10.6% | Small Cap 14.8% | Fixed Income -13.0% | EM Equity 4.0% | Asset Alloc. 6.1% | Comdty. 20.2% |
| Small Cap -33.8% | Small Cap 27.2% | Large Cap 15.1% | Cash 0.1% | Small Cap 16.3% | High Yield 7.3% | Small Cap 4.9% | DM Equity -0.4% | EM Equity 11.6% | Asset Alloc. 14.6% | Large Cap -4.4% | Asset Alloc. 19.5% | DM Equity 8.3% | Asset Alloc. 13.5% | Asset Alloc. -13.9% | High Yield 3.1% | High Yield 5.4% | DM Equity 20.0% |
| Comdty. -35.6% | Large Cap 26.5% | High Yield 14.8% | Asset Alloc. -0.7% | Large Cap 16.0% | REITs 2.9% | Cash 0.0% | Asset Alloc. -2.0% | REITs 8.6% | High Yield 10.4% | Asset Alloc. -5.8% | EM Equity 18.9% | Fixed Income 7.5% | DM Equity 11.8% | DM Equity -14.0% | Fixed Income 3.0% | Fixed Income 2.7% | Large Cap 17.7% |
| Large Cap -37.0% | Asset Alloc. 25.0% | Asset Alloc. 13.3% | Small Cap -4.2% | Asset Alloc. 12.2% | Cash 0.0% | High Yield 0.0% | High Yield -2.7% | Asset Alloc. 8.3% | REITs 8.7% | Small Cap -11.0% | High Yield 12.6% | High Yield 7.0% | High Yield 1.0% | Large Cap -18.1% | Small Cap 2.7% | DM Equity 2.3% | High Yield 13.0% |
| REITs -37.7% | Comdty. 18.9% | DM Equity 8.2% | DM Equity -11.7% | Fixed Income 4.2% | Fixed Income -2.0% | EM Equity -1.8% | Small Cap -4.4% | Fixed Income 2.6% | Fixed Income 3.5% | Comdty. -11.2% | Fixed Income 8.7% | Cash 0.5% | Cash 0.0% | EM Equity -19.7% | REITs 1.7% | EM Equity 1.0% | Asset Alloc. 12.4% |
| DM Equity -43.1% | Fixed Income 5.9% | Fixed Income 6.5% | Comdty. -13.3% | Cash 0.1% | EM Equity -2.3% | DM Equity -4.5% | EM Equity -14.6% | DM Equity 1.5% | Comdty. 1.7% | DM Equity -13.4% | Comdty. 7.7% | Comdty. -3.1% | Fixed Income -1.5% | Small Cap -20.4% | Cash 1.1% | Cash 0.6% | Fixed Income 4.2% |
| EM Equity -53.2% | Cash 0.1% | Cash 0.1% | EM Equity -18.2% | Comdty. -1.1% | Comdty. -9.5% | Comdty. -17.0% | Comdty. -24.7% | Cash 0.3% | Cash 0.8% | EM Equity -14.2% | Cash 2.2% | REITs -5.1% | EM Equity -2.2% | REITs -24.9% | Comdty. -8.0% | Comdty. -2.6% | Cash 0.4% |

All the performance data shown represents past performance. Past performance is not an indicator of future results. Source: J.P. Morgan Asset Management, Guide to the Markets.

The most important takeaway from the pigs' experience is that the Big, Bad Wolf will always come knocking, so it's best to prepare ahead of time. Not by relying on the high-risk "House Made of Straw" investments nor by hiding in the no-risk, no-reward "House Made of Twigs" portfolio. Drawing on a full spectrum of investments, an investor can build a portfolio that can much more easily weather the Big Bad Wolf's tantrums. And, hopefully you'll avoid having to bunk up with your brother.

Best wishes and good investing,

Barry

*(for important disclosures, see the next page)*

*Important Disclosures*

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