Lifecycle Investing: A New, Safe, and Audacious Way to Improve the Performance of Your Retirement Portfolio

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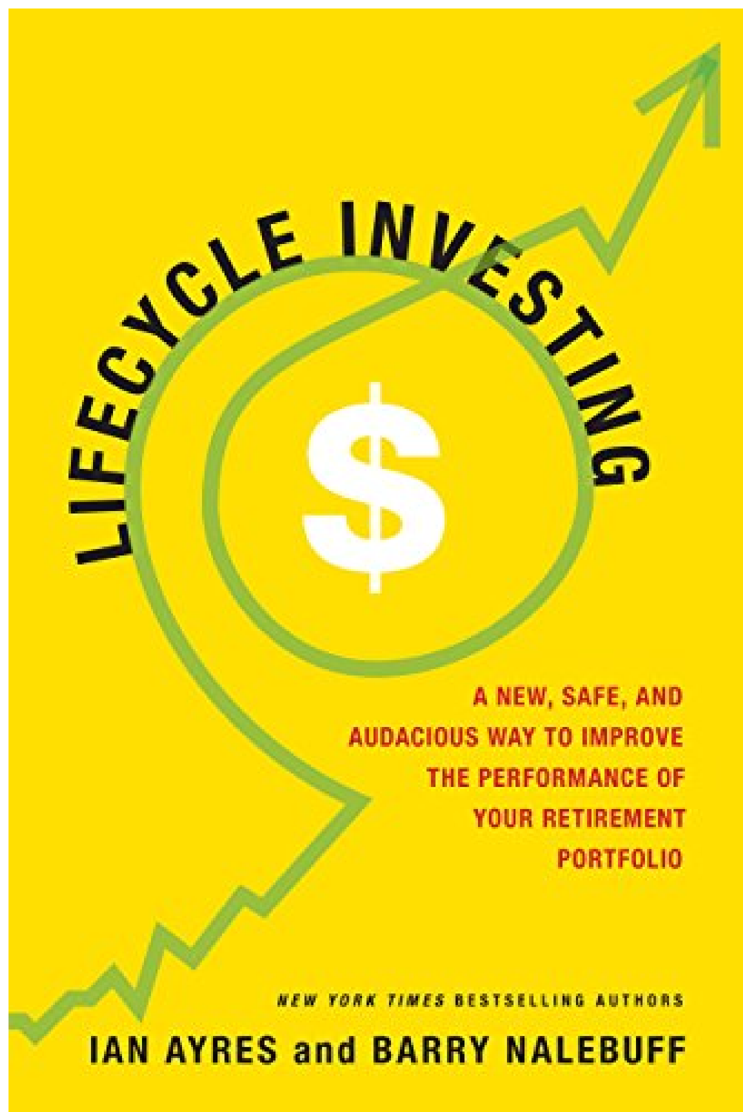

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Ian Ayres, Barry Nalebuff : Lifecycle Investing: A New, Safe, and Audacious Way to Improve the Performance of Your Retirement Portfolio before purchasing it in order to gage whether or not it would be worth my time, and all praised Lifecycle Investing: A New, Safe, and Audacious Way to Improve the Performance of Your Retirement Portfolio:

10 of 11 people found the following review helpful. An EXTREMELY Important BookBy Eric E. HaasI believe that

this is a ground-breaking book.Here's a summary:1) Most folks tend to have the overwhelming majority of their exposure to the stock market (i.e., most dollar-years of stock market exposure) during a one-to-two decade period late in life (e.g., perhaps during their 50s). The reason for this is that folks tend to accumulate wealth exponentially -- they save exponentially and their investments tend to grow exponentially.2) This generally works fine UNLESS they are unlucky and the stock market suffers through a bad decade when they have the most dollars exposed thereto.3) The main idea here is that you would be better off, conceptually, if it were somehow possible to more evenly spread out your stock market exposure over your entire life. This idea of "time diversification" is quite sound. If you were somehow able to do that, and during the decade of your 50s the stock market goes to h*ll, so what! You've hot lots of other decades of stock market exposure to make up for it!4) Of course, the devil is in the details. Is it possible to more evenly spread out your stock market exposure through your entire life? Yes.a) The authors go into great detail about how you can move towards that goal by having greater than 100% exposure to stocks early in life. This can be done in many ways -- using options, futures, or buying on margin. And yes, this sort of thing can be dangerous for the layperson to attempt. I don't recommend it -- but keep reading.b) Their recommended approach is to get roughly 200% stock exposure early in your adult life by buying deep-in-the-money call options on stock indexes, or perhaps broad market ETFs.c) They simulated their approach using actual US stock market data from 1871 to 2009, assuming that each year beginning 1871, an adult started investing -- and modeling what their ending wealth would be at retirement (and note that this period included the great depression)- One strategy was a constant 75/25 stock/bond allocation throughout life.- The second strategy was the common rule of thumb that one ought to have a stock allocation equal to 110 minus your age (so at age 20 you are 90/10 stock/bonds, at age 40 you are 70/30 stock/bonds, etc.).- The third strategy was implementation of their approach (i.e., 200/0 stock/bond allocation till age 40 or so, then ramping down to 50/50 at retirement).The results are startling for the layperson (but shouldn't be a surprise if you accept the idea that diversification is a good thing -- and thus time diversification should give you the benefit that it actually does). But here's the results: The 75/25 strategy and their approach had the same average wealth at end of life. HOWEVER, their approach had a 20% smaller standard deviation. Standard deviation is the traditional measure of risk in financial economics. So this is proof that diversification of stock market exposure over time reduced risk for the same expected return. Thus, by taking on more (MUCH MORE) risk early in life, the riskiness of your ending wealth is lessened. Is this data mining? No -- the data just confirms what you should expect.d) As a financial professional, I don't think that their idea of going with greater than 100% stock exposure is feasible or prudent for the overwhelming majority of investors. While they suggested a pragmatic cap of 200% stock exposure, I suggest a much more realistic 100% as max level of stock exposure.e) The real benefit I see from this book isn't the controversial idea of using leverage, but rather the idea that it is beneficial to have much higher stock exposures early in life (maybe as high as 100%) than most folks had previously imagined. So a good approach might be to have 100% in stocks until age 40 to 50 or so -- and then start reducing it until it is at 50/50 or so at age 60 to 70, where you might want to keep it for the successive few decades. I now have several clients doing this. It makes sense -- If (and only if) you can psychologically tolerate the somewhat higher volatility early in life which such an approach suggests.I personally think that this book is perhaps one of the two most important investing books of the past ten years or so (the other being Reichenstein/Jennings Integrating Investments the Tax Code).4 of 4 people found the following review helpful. Interesting BookBy Christopher BahrAs a CPA and a person with a masters degree in finance, I found the book to be very interesting and I plan to apply the principles in my personal finances. I'm in my late 20's, save over 50% of my income yearly, have a stable job so I fit the ideal profile very well.This book is for people with basic money skills and not the general population who hold high interest consumer debts.0 of 1 people found the following review helpful. A great book for a young investorBy N. ShafferI am not an expert in finance. I have done a lot of reading about personal investment strategies. I have also had the opportunity to hear from experts on prudent retirement investments through my previous job (ERISA litigation related). Based on what I know, I think that this book is an important tool for young investors who are worried about retirement and are willing to take steps to secure their future. I do not think that this book is a comprehensive guide to investing in the long term.The basic strategy of the book -- investing a relatively stable amount of money across time in order to reduce risk -- makes sense. I will note that Robert Schiller, who has a reputation for cautious opinions, has endorsed this book. I will also note that the authors are not exactly slouches. Aside from the credentials of the book's proponents, investing over time does seem to reduce risk, and the argument presented in this book is very persuasive.I think that this book is most useful when read in conjunction with another book like Malkiel's "A Random Walk Down Wall Street," which extolls the virtues of low cost index fund investing and asset-class diversification. The reason that I would read this book with another like Malkiel's is that the strategy in this book almost sounds too good to be true, and its enthusiasm can be a little contagious. A tempered analysis provides some background and perspective, such that an individual can compare strategies and determine what, if any, role leverage should have in a retirement portfolio.I have a couple of suggestions for a second edition of the book.1) The authors should provide a more comprehensive guide to LEAPs, especially since investing on margin is not permitted in tax sheltered retirement accounts. The book is not exactly clear on the strategy here, and it does not discuss the pros and cons of selling the option before expiration to wind down the position versus exercising the option

(if you have the cash to do so). It's also not clear to me from the book that the authors intend for most people to sell LEAPs before they expire, but I gather that is the approach.2) The authors should provide a more detailed description of how one can evaluate the prospective cost of borrowing. While I know that no one can predict what the market is going to return, it would be helpful for the book to walk you through exactly what kind of return you should expect to break even, in light of the cost of borrowing. I think I have this analysis figured out (if the market returns a percentage equal to 1/2 of the implied interest rate of borrowing, I think you break even), but I'm not entirely sure and the book doesn't go into detail on this.3) The elephant in the book is student loans. A discussion of how student loans (with a slight tax advantage equal to your marginal rate time interest paid capped at $2500) with relatively high interest rates (6.8%-8.25% for most people these days) compare to a tax-sheltered retirement account that benefits from compound rather than simple interest. Further, and this is probably beyond the scope of the book, an analysis of student loan repayment plans that permit moderate income borrowers to avoid interest capitalization nearly indefinitely as compared to a tax advantaged retirement account would also be helpful.In sum, I recommend this book. This is not the first book you should read about personal investing, and it should probably not be the last. I think that some more information on the areas outlined above would also be helpful.

Diversification provides a well-known way of getting something close to a free lunch: by spreading money across different kinds of investments, investors can earn the same return with lower risk (or a much higher return for the same amount of risk). This strategy, introduced nearly fifty years ago, led to such strategies as index funds. What if we were all missing out on another free lunch thatrsquo;s right under our noses? In Lifecycle Investing, Barry Nalebuff and Ian Ayresmdash;two of the most innovative thinkers in business, law, and economicsmdash;have developed tools that will allow nearly any investor to diversify their portfolios over time. By using leveraging when youngmdash;a controversial idea that sparked hate mail when the authors first floated it in the pages of Forbesmdash;investors of all stripes, from those just starting to plan to those getting ready to retire, can substantially reduce overall risk while improving their returns. In Lifecycle Investing, readers will learn

Robert Shiller, author of Irrational Exuberance" A most provocative book. The real advantages of time diversification have never been laid out so clearly or with such a program of action." Tim HarfordFinancial Times"Here are the chief investment lessons of the financial crisis for todayrsquo;s young people: they should be buying more shares and running up debts to do so. . . . [T]here is nothing intrinsically risky about regular borrowing to get that fund off to an early start. . . . Not only does the concept make sense, it has paid off in the past. . . . Ayres and Nalebuff have looked at historical stock market data. . . . For every single cohort, the early leverage strategy beat the conventional wisdom." Moshe A. Milevsky, Ph.D., Finance Professor, York University, and author ofAre You a Stock or a Bond?ldquo;This bold book promotes more early equity exposure for the masses, precisely at a time when many practitioners are re-thinking the lsquo;buy and hold stocks for the long runrsquo; mantra. Whether you are comfortable with this strategy or not, the book is a must read for anyone who claims to think about their personal finances in a rigorous and logical manner.rdquo;