

# 20/20 Vision

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Looking Back on 20 Years of Defining Risk



David Lovell | July 11, 2017 | Updated: January 29, 2018 | [Swan Insights](#)

## Quick: Where Were You 20 Years Ago?

Allow me to provide some context.

In the spring, “Wannabe” by the Spice Girls was the #1 song in America, later followed by “MMMBop” by Hanson. *Men in Black* would dominate the summer box office, but it would be dwarfed by *Titanic* later on in the year. Tim Duncan had just been drafted by the San Antonio Spurs and the Houston Oilers departed to Tennessee. People were starting to worry about the dreaded “Y2K” bug.

While many use cultural milestones like music, movies, or sports to mark a time and a place, let’s look at where the capital markets were.

### Market Flashback

In July 1997, the Dow Jones Industrial Average crossed 8,000 and the S&P 500 cracked 900<sup>1</sup>, both firsts. Apple Computers was a joke, Amazon.com was an online bookstore, and Google, Facebook, and YouTube did not yet exist. Alan Greenspan had warned about “irrational exuberance” creeping into the market in December 1996, but the Dot-com Bubble was still a year or two in the future. On July 1st, 1997, 3-month yields were 5.31% and 30-year Treasury bonds yielded 6.74%<sup>2</sup>.

July 1997 was also when Randy Swan launched the Defined Risk Strategy (DRS). Randy’s vision was, and remains, to offer investors a unique approach to investing and an alternative to the traditional 60/40 portfolio. With the love and support of his wife Laura, Randy moved to Durango, Colorado to establish what was then called Swan Consulting.

The goal was to “build a better mousetrap”—to design an investment strategy that addressed the shortcomings of traditional asset allocation. Traditional asset allocation seeks to mitigate risk through diversification, but one of the main caveats of asset allocation is that market risk cannot be diversified away.

To Randy, leaving the biggest source of risk unaddressed was unacceptable; therefore, if market risk cannot be diversified away, the DRS sought to hedge it away.

### Crises, Challenges, and Calamities

While the previously mentioned Y2K bug turned out to be a non-issue, the last twenty years have seen a multitude of market environments:

- 1998 – Russian default/LTCM crisis
- 1999 – Dot Com mania and day-trading lead to frenzied valuations
- 2000 – Dot Com bubble bursts
- 2001 – September 11th attacks, invasion of Afghanistan
- 2002 – Sarbanes-Oxley Act passed in the wake of accounting scandals at Enron, Tyco, MCI Worldcomm, etc.
- 2003 – The Iraq War initiated
- Mid-2000s – Housing bubble inflates
- 2007-09 – Housing bubble bursts; biggest financial crisis since Great Depression
- 2008 – Oil hits \$147/barrel
- 2009-2012 – Euro crisis, focused on Greece but also driven by Portugal, Ireland, Spain and Cyprus. Period of ultra-loose monetary policy of low rates and quantitative easing

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<sup>1</sup> Source: [finance.yahoo.com](http://finance.yahoo.com)

<sup>2</sup> Source: <https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield>

- 2010 – “Flash Crash” in May; intra-day losses on the DJIA are almost 1,000 points
- 2011 – Downgrade of U.S. Treasury debt from AAA to AA
- 2015-2016 – Fears of a “hard landing” in China cause steep sell-offs in August 2015 and early 2016
- 2016 – Oil falls to below \$30 per barrel as shale-based fracking revolutionizes energy markets. Brexit, election of Donald Trump and other populist-fueled political developments
- 2017 – U.S. equity markets continue to set all-time highs

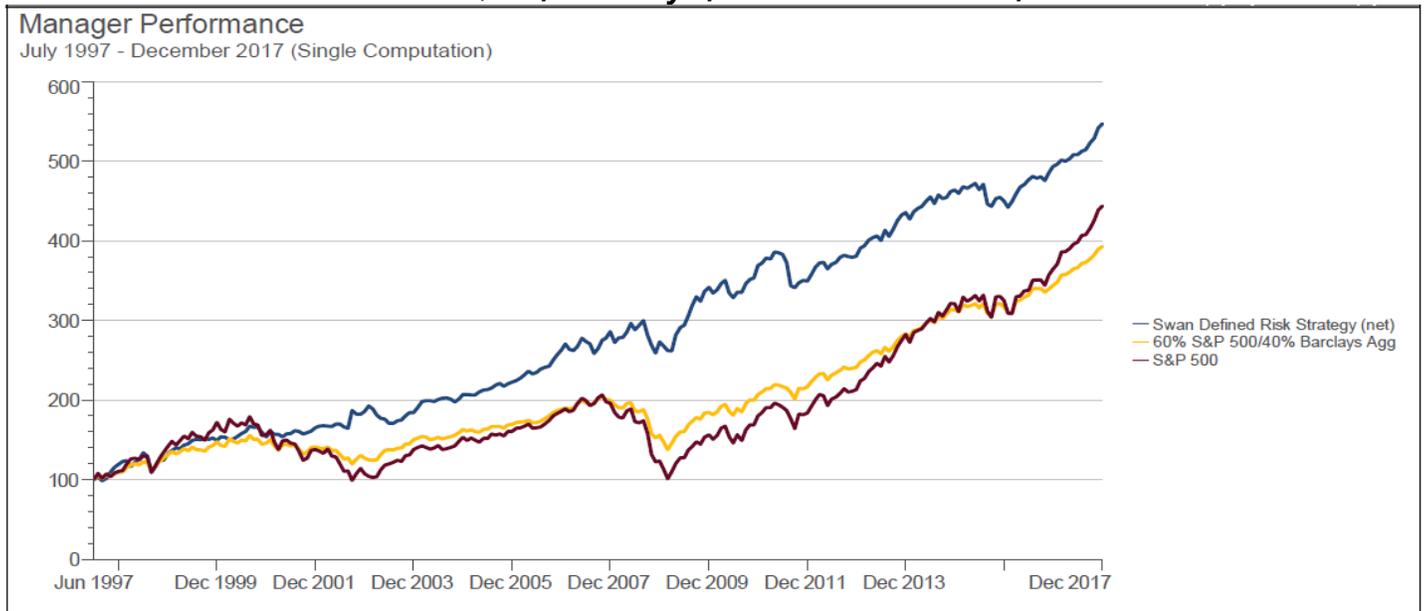
Just about every market environment imaginable has happened over the last 20 years: the two largest bear markets since World War II as well as the second-longest bull market in U.S. history; losses of 50% as well as gains of 300%; short-term shocks and corrections; two wars and an attack on American soil; a reversal in the multilateral, collaborative, post-World War II order; technological innovations unimaginable in 1997; and commodities at historic highs as well as lows.

## How Did the Defined Risk Strategy Weather?

While the markets have undergone significant changes, the Defined Risk Strategy has not. The overall goal remains the same: maximize the return-risk trade-off by minimizing the impact of down markets. We remain “always invested, always hedged” by actively hedging our holdings in the market.

How has Swan delivered on this goal?

### Swan Defined Risk Strategy Select Net-of-Fees Growth of \$100,000 - July 1, 1997 to December 31, 2017



Multi-Statistic (Custom Table)  
July 1997 - December 2017: Summary Statistics

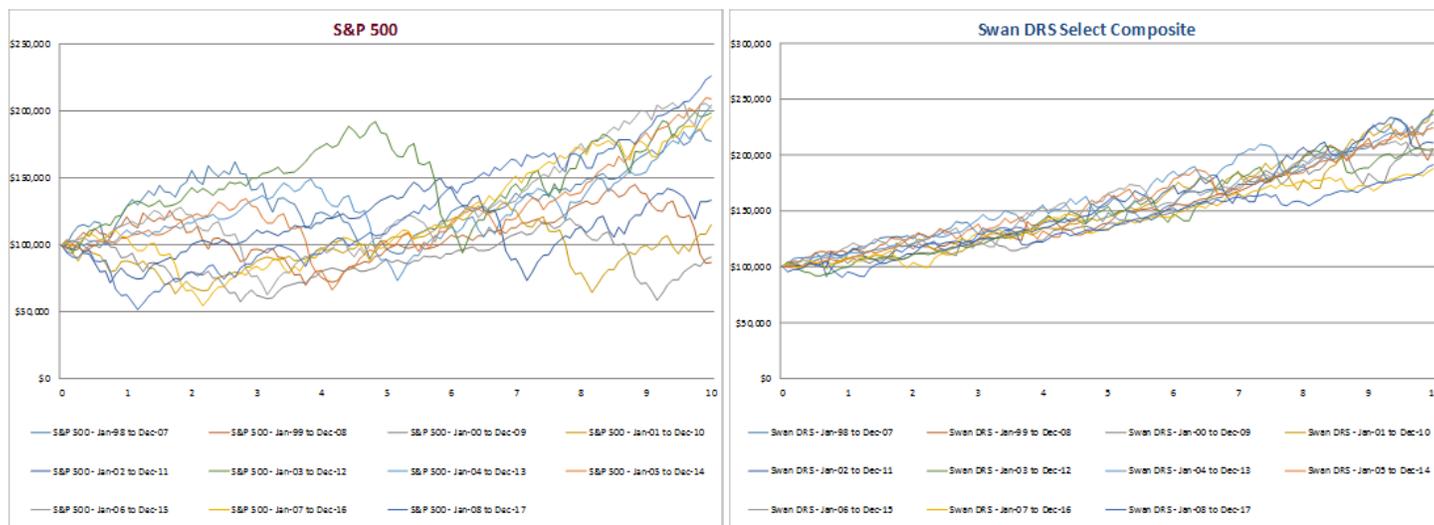
	Return	Cumulative Return	Standard Deviation (Population)	Beta vs. Market	Excess Return vs. Market	Sharpe Ratio
Swan Defined Risk Strategy (net)	8.64%	446.89%	9.40%	0.30	1.10%	0.70
60% S&P 500/40% Barclays Agg	6.90%	292.87%	8.96%	0.59	-0.64%	0.54
S&P 500	7.54%	343.80%	14.90%	1.00	0.00%	0.37

Source: Zephyr StyleADVISOR, Swan Global Investments, and Morningstar. The Barclays U.S. Aggregate Bond Index and the S&P 500 Index are unmanaged indices, and cannot be invested into directly. Past performance is no guarantee of future results. DRS results are from the DRS Select Composite, net of fees, as of 12/31/2018. Structures mentioned may not be available within your Broker/Dealer.

The Swan Defined Risk Select Composite has historically outperformed both the S&P 500 and a blended 60/40 stock/bond mix, on both an absolute and risk-adjusted basis. It's important to keep in mind what that blue line incorporates. It's not just 20 years—it's all those crises listed above. The DRS has been battle-tested through all the aforementioned events.

Of course, someone might legitimately claim that very few people would have been invested in the DRS for that full 20-year period, which is what the previous graph represents: the entire history of the DRS.

So what if someone had only been invested for a sub-period...say, for example, a period of 10 years rather than 20?



Source: Zephyr StyleADVISOR, Swan Global Investments

The above comparison is one of Swan's most popular graphs showing eleven, 10-year investment periods. The first period is 1/1998 to 12/2007; the last period is 1/2008 to 12/2017. Each line represents a ten-year investment period with a different inception date (when the initial investment was made).

In other words, the lines chart the "ride" investors experienced over 10 years in the S&P 500 (left) or the DRS (right), if they were to simply change the date of their initial investment.

The contrast in outcomes is stark. While the unhedged S&P 500 has had outcomes all across the board, the DRS has been able to maintain a much tighter range of outcomes by mitigating the impact of those two big bear markets.

We have run similar analysis over 3, 5, and 15 year rolling periods, which are available to investment professionals and advisors upon request. Investors should contact their financial advisor to learn about the significance of rolling period returns.

## Consistency as the Key to Long-Term Growth

Throughout the last twenty years the DRS has remained very consistent, both in terms of investment results as well as the underlying investment process. What has changed is Swan Global Investments as an organization.

What started as a one-person shop with a few million under management has grown to over forty team members and \$5.03bn AUM.

The DRS is available across multiple asset classes and in different investment structures: a separately managed account, in mutual funds, CITs, or customized solutions.

Furthermore, Swan is consistently publishing research and is recognized as a leader in options and hedged equity.

## Looking Forward

What might the future bring? On July 1st, 2037, what events will have occurred in the market? What innovations will be commonplace? What will the world look like?

No one knows. If the last twenty years are any guide for the next twenty, it is reasonable to expect bull markets and bear markets, unforeseen events, and a lot of volatility along the way.

Whatever the future brings, the DRS was designed as a full market cycle solution with meaningful upmarket participation and significant down-market protection.

We look forward to the challenge.



**About the Author:** David Lovell, Director of Marketing, is responsible for Swan's marketing and engagement initiatives. This includes development and execution of marketing programs for Swan's websites, content, communications, events, and media. David began his career in the financial industry at Mass Mutual. David currently holds a Series 65 license.

### Important Notes and Disclosures:

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