Diversify to defend against portfolio drawdowns

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Diversification is always a good idea. There's always going to be risk in markets, you never know exactly what's going to happen.

Often people ask, "When does diversification work, when does diversification not work?" I think one of the ironies is that diversification sometimes doesn't work when things are going great, when things are going really well, when markets are going straight up, like they did for a lot of 2017 and the first 3 quarters of 2018. You don't necessarily need as much diversification, because stocks are going straight up. But it's when things start to fall apart a little bit, there's more volatility, there's more uncertainty, that's when you want to make sure that your portfolios are as diversified as possible.

And that applies across asset classes, it applies within asset classes. So if you're going to have equity, stocks in your portfolio, make sure to have global stocks, not just domestic stocks. Make sure to have emerging market stocks, not just developed stocks.

In a fixed income portfolio, make sure to have treasuries, make sure to have investment-grade corporates, high-yield corporates, emerging market debt, inflation-linked bonds, as many different asset classes as you possibly can. And then even beyond traditional equity and fixed income assets, look for ways to include commodities, look for ways to include real estate, look for ways to include alternatives.

"What's the point of all this? One of the main points of this, I believe, is to avoid drawdowns. You can look at the stock market over the long-run, and say, "This is a great place to put my money, it just goes up, up, up, up, up." But what's going to happen eventually is that it's going to come down. And that's when we're going to start to see the impact of draw-downs.

The more that you can diversify into different areas, the more that you can mitigate against those draw-downs.
