

## The Barbell Strategy



In weightlifting, weights are loaded at opposite ends of the bar. In the investment world, it is also possible to focus on the two ends of the risk scale and avoid the “**boring middle**”.

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An essential step in the investment process is to determine the type of strategy to adopt. This can be a long and tedious exercise, as there are a wide variety of approaches, each with its own advantages and disadvantages. The investment strategy involves choosing the proportion of financial instruments (stocks, bonds and alternative investments) that make up your portfolio based on your objectives, risk tolerance, time horizon and future capital needs.

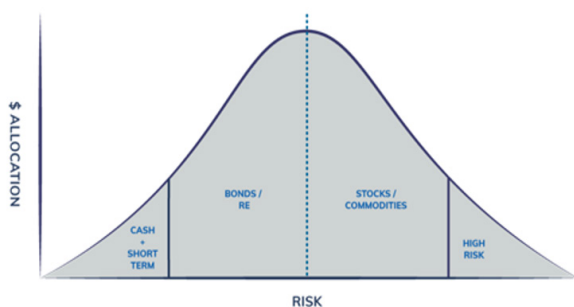
**Some strategies focus more on capital appreciation while others focus on generating fixed returns and wealth preservation.**

But investors can also consider a combination of these two styles. This is known as the "Barbell" strategy.

**Definition**

The idea was popularized by Nassim Taleb, former hedge fund manager and author of the book "Black Swan". It has since been taken up by famous investors such as Ray Dalio and Mohammed El'Arian. Their theory: most of a person's wealth should be invested in ultra-secure investments, while the rest is invested in high-risk instruments with high appreciation potential. The fundamental concepts are those of risk and probability. Below, you can see the distribution of the different asset classes according to their risk and median allocation in traditional portfolios.

**Risk of different types of instruments and typical allocation in traditional portfolios**



Source: Bloomberg

The barbell investment strategy advocates combining two distinctly different baskets of investment assets - splitting them between the two extremes and leaving almost nothing in the middle. So instead of your portfolio being slightly conservative or aggressive, it is both hyper-conservative AND hyper-aggressive.

Because of this construction, it limits downside risk - the total amount that can be lost - while exposing you to potentially unlimited upside.

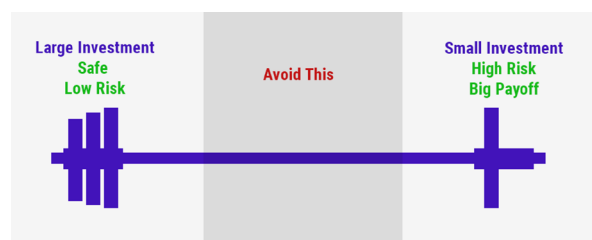
Taleb suggests allocating 85% to 90% of assets in ultra-secure investments. The remaining 10% to 15% can be

invested on a limited basis in speculative assets such as small and medium-sized companies, venture capital, emerging markets and cryptocurrencies.

The Barbell method is not a specific allocation but rather a different perspective on risk. It aims to achieve the following objectives:

1. Aggressively protect the downside: avoid bankruptcy in order to always remain exposed to the financial markets. This means never investing more than you can afford to lose
2. Gain exposure to financial instruments with very high upside potential.
3. Avoid the "boring middle": Assets in the middle of the risk scale are expected to produce relatively poor performance while exposing the portfolio to some risk.

Here is an example of what a "barbell" portfolio might look like:



On the left is the hyper-conservative portfolio (which constitutes 85% to 90% of the assets). Its objective is to beat the inflation rate or at least come close to it - but with very limited risk. It can include cash, government or corporate bonds of high quality (with short duration), or equities belonging to defensive sectors and paying a high dividend rate.

On the right is the hyper-aggressive portfolio (with a much lower allocation than the hyper-conservative portfolio). It can be made up of small-cap stocks with very high growth prospects, venture capital companies, crypto-currencies, etc.

**Eliminate the risk of bankruptcy**

When it comes to portfolio allocation, Taleb believes that many professionals have misunderstood how to generate gains over the long term. They think their ongoing goal should be to find investments that make them a lot of money.

But another priority is to minimize losses. A very high allocation to safe, low-risk investments has the key advantage of protecting investors from the risk of bankruptcy. When it comes to trading and investing, capital preservation is key. As Warren Buffett said, "The first rule of investing is: never lose money. The second rule of investing is: never forget rule number one."

In a "barbell" strategy, the bulk is allocated to hyper conservative investments, which greatly eliminates the risk of bankruptcy.

## Barbell strategy versus balanced portfolio?

In general, balanced portfolios are invested in a diversified range of stocks, bonds, real estate and alternatives like gold for safety. The idea here is to create stability by allocating assets with different risk/return profiles.

Although tactical adjustments may occur, the asset allocation within this type of portfolio does not change substantially. The performance is more or less stable but often mediocre over the long term.

By using a barbell strategy, investors can generate significant gains in sectors that have the potential to outperform the market, while reducing the risk of loss through low-risk investments.

## Performance in times of high volatility

The Barbell strategy has proven resilient during past periods of increased volatility.

During the Great Financial Crisis, equity markets collapsed between September 2008 and February 2009. U.S. equity benchmarks fell by 43%, but a dumbbell portfolio of U.S. stocks lost only 14%.

By 2022, the environment was significantly more complicated. Speculative investments (cryptos, venture capital, growth stocks) suffered badly, but some of the instruments that make up the defensive side - and in particular bonds - did not play their usual role as downside protection. The liquidity portion also failed to protect portfolios against rising inflation and therefore generated negative real returns.

However, 2022 was a very atypical year in which the traditional strategies also suffered greatly.

Over the long term, the barbell strategy works relatively well in downturns while generating strong capital appreciation in upturns.

## The "barbell" strategy applied to different asset classes and... to everyday life

The barbell strategy can be used within bonds, stocks, real estate, venture capital, cryptocurrencies, etc. In the bond world, the barbell strategy involves investing on both ends of the yield curve, i.e. short and long durations (while avoiding the middle). In the equity markets, it consists of

allocating a large portion of the portfolio to large caps in defensive sectors and a much smaller allocation to small caps with high appreciation potential (but also very risky).

It is also interesting to note that we unconsciously apply the barbell strategy in our daily lives. Some examples.

Family time. We avoid distractions when we spend time with our family. We give our full attention to the children on weekends, and work the rest of the week with little or no sight of them.

Work. To be effective in your work life, avoid working in a fragmented way all day. Work in short, intense bursts and relax when the work is done.

Diets. The Slow Carb Diet recommends a low-carb, high-protein diet, but encourages one cheat meal per week.

Fitness. Contrast therapy involves more extreme exposure to hot and cold. You can reap more health benefits by alternating cold showers and hot saunas rather than lukewarm showers.

**Grab your dumbbells! (and eat your cheat meals!)**

## For further information

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