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**Article Title:** [A Nibble from the Free Lunch](#)

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**Precise:** Modern Portfolio Theory (MPT) is a powerful risk management tool. History has proven its reliability in reducing investment-related risk and/or increasing expected returns. Although required of fiduciaries and used routinely at large institutions, individual investors are often not educated in this crucial investment discipline.

**Summary:** Investors who hope to develop an optimal investment portfolio will find it virtually impossible to do so without understanding the basic tenets of MPT. Although simple enough in concept for a child to understand, the benefits in terms of increased returns and/or reduced risk are significant.

MPT essentially demonstrates that:

- Investment risk is quantifiable and can be measured relative to expected return;
- Generally speaking, riskier investments will compensate investors with higher expected returns;
- Because the expected returns of different investments are not perfectly correlated, investors can reduce risk and/or increase expected returns at the portfolio level beyond those of individual investments through strategic diversification;
- Diversification among asset classes produces an “efficient frontier” upon which expected returns can be maximized for a given level of risk and/or risk can be minimized for a given return expectation; and
- Any investment portfolio residing outside of the “efficient frontier” exposes the investor to uncompensated risk or diminished returns.

**Relevance and Application:** The advent of Modern Portfolio Theory has dramatically impacted investment management. As the most scientifically demonstrable tool of investment management, MPT should be a part of every family’s investment strategy.

Despite the simplicity of the concept, the infinite selection of investments available in the marketplace today makes implementation difficult without appropriate software and industry knowledge. However, MPT should be understood by anyone investing wealth in the marketplace and incorporated into portfolios even of modest size by a qualified investment advisor.