



BUILDING MORE RESILIENT PORTFOLIOS

Why Resilience May Matter More Than Return

LodeStar Advisory Group LLC

Naples, Florida

www.Ldstar.com

ABOUT LODESTAR ADVISORY GROUP LLC

LodeStar Advisory Group LLC® is a fee-only, fiduciary wealth management firm based in Naples, Florida. We work with a limited number of families and individuals with substantial capital who require rigorous judgment under complexity rather than broad accessibility.

- ◇ **INDEPENDENT FIDUCIARY ADVICE.**
- ◇ **DELIBERATE RISK ARCHITECTURE.**
- ◇ **APPLIED DECISION SCIENCE.**

OUR GUIDING PRINCIPLES

- **Judgment Under Complexity.** Most advisors optimize for access. We optimize for the quality of decisions when capital and circumstances are consequential.
- **Asymmetric Construction.** Portfolio architecture should be engineered so that upside meaningfully outweighs downside across full market cycles.
- **Process Over Narrative.** Risk budgets and decision parameters are established in advance. Adjustments are judgement-driven, informed by data, and market conditions, and made within a defined architecture rather than improvised under stress.
- **Fiduciary Independence.** Fee-only. NAPFA-Registered. No product sales, no commissions, no third-party allegiances.

Return is what investors talk about in calm markets. Resilience is what determines whether the plan survives the markets that are not calm.

1. The Incomplete Objective

Most portfolio conversations begin with return. Target returns are set, historical averages are cited, and asset allocation is framed as the search for the highest expected return at an acceptable level of volatility. That framing is not wrong. It is incomplete.

For clients with substantial capital – particularly those approaching or in retirement – the binding constraint is rarely the average return over a long sample. It is the depth and duration of the losses that interrupt compounding, force spending from a depleted base, or trigger irreversible behavioral decisions. A portfolio that delivers a higher average return but experiences a larger, longer drawdown can leave the client permanently worse off than a portfolio with a modestly lower average return and a thinner left tail.

Resilience, in this sense, is not the absence of volatility. It is the capacity of the portfolio – and of the client’s plan – to absorb stress without permanent impairment of capital or of decision quality. Building that capacity is a design problem, not a forecasting problem.¹

2. Why the Mathematics Favor Resilience

The recovery mathematics are unforgiving and widely under-appreciated. A 20% decline requires a 25% gain to recover. A 30% decline requires 43%. A 40% decline requires 67%. At a realistic 8% annualized recovery rate, a 40% drawdown can consume nearly seven years of subsequent compounding – years that a client in distribution may not be able to wait out without changing spending or abandoning the plan.

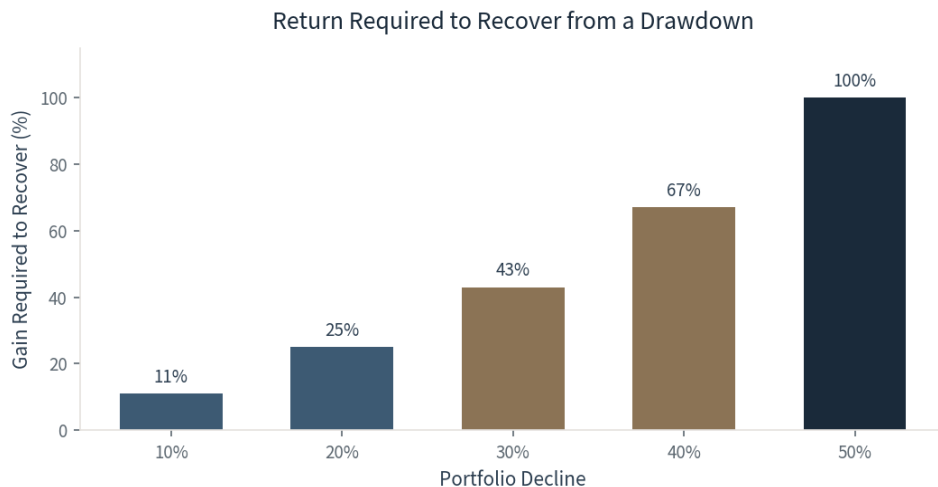


Exhibit 1. Gain required to fully recover from a portfolio decline.

Limiting the depth of major drawdowns is therefore not a secondary objective. It is a primary determinant of long-term compounded wealth and of the durability of the client's spending plan. Resilience compounds. Severe losses compound in the opposite direction.²

3. What Resilience Looks Like in Practice

A resilience-oriented portfolio is not a low-return portfolio. It is a portfolio whose architecture is deliberately asymmetric: designed so that the left tail is thinner and recovery periods are shorter, while participation in the long-term growth of productive capital is preserved.

In practical terms, resilience is built from three interlocking design choices:

1. **An explicit risk budget.** The maximum risk the portfolio is designed to take – and the maximum drawdown the client can reasonably sustain – is stated in advance. Capital weights are the residual of risk weights, not the starting point.
2. **Regime-aware adjustment.** Exposure is modulated when observable indicators signal elevated tail risk, within pre-defined parameters. Risk is restored only after sustained normalization. The process is asymmetric by design: faster to reduce, slower to restore.
3. **Diversifying return streams inside the budget.** Independent premia – obtained, where appropriate, through capital-efficient vehicles – expand the sources of return without exhausting the risk budget or displacing the core growth and ballast allocations.

These are the practical expressions of Dynamic Risk Budgeting, Adaptive Allocation, and Return Stacking. Together they form a single architecture whose organizing objective is resilience under complexity.³

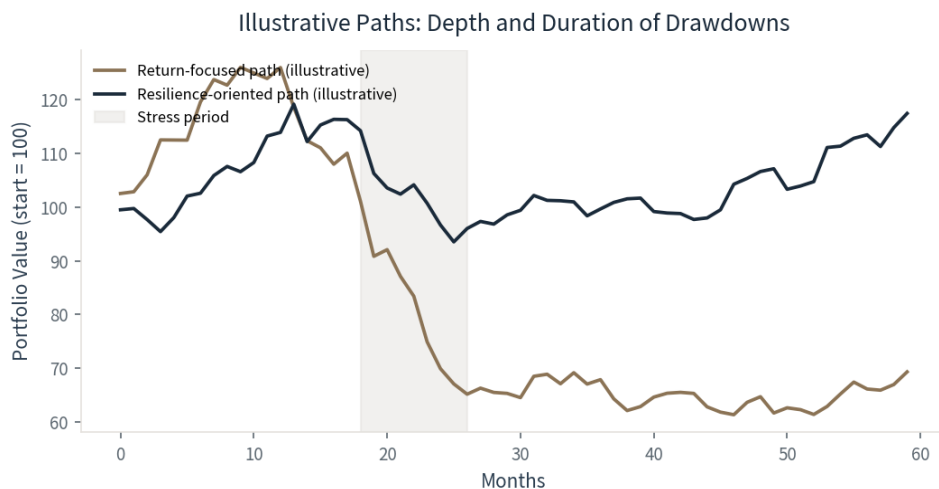


Exhibit 2. Illustrative paths. The resilience-oriented path moderates depth and duration of the stress period; paths are conceptual, not historical results.

4. The Behavioral Dimension

Resilience is not only a property of the portfolio. It is a property of the decision process that surrounds it. Large drawdowns do more than reduce capital. They intensify loss aversion, shorten perceived time horizons, and raise the probability that the client will abandon the plan at the moment recovery is most needed.

A process that has already reduced risk before the worst of a decline arrives shrinks the size of the loss the client must endure. In doing so, it reduces the behavioral pressure to make irreversible decisions under stress. Decision parameters established in advance exist as much to protect the decision-maker as to protect the capital. That is applied decision science in the service of resilience.⁴

5. Relevance for Substantial Capital

For clients with investable assets of \$1 million to \$10 million – and especially those near or in retirement – sequence risk, spending needs, and the psychological cost of large losses all amplify the value of resilience.

A deeper drawdown is not merely a temporary mark-to-market event. It can force a permanent reduction in lifestyle, a delayed retirement, or a change in the plan that cannot be reversed even if markets recover.

In that context, optimizing solely for average return is a mis-specified objective. The relevant question is whether the portfolio is engineered to keep the plan intact across the range of regimes the client is likely to encounter. That is a resilience question first and a return question second.⁵

6. Conclusion

Return attracts attention. Resilience determines outcomes. Building more resilient portfolios requires an explicit risk budget, regime-aware adjustment within pre-defined parameters, and the disciplined use of diversifying return streams inside that budget. None of these elements guarantees a higher return in every environment. Together they seek to limit the depth and duration of the losses that permanently impair capital and decision quality.

For clients whose capital is substantial and whose decisions carry lasting consequences, resilience is not optional sophistication. It is one practical expression of fiduciary care.

Notes

1. The distinction between average return and path-dependent outcomes is central to the sequence-of-returns literature and to the practical experience of investors in distribution. See also the companion paper *Dynamic Risk Budgeting: A Disciplined Framework for Engineering More Resilient Portfolios*.
2. Recovery mathematics are elementary but frequently under-weighted in portfolio construction. Magdon-Ismail & Atiya (2004) and subsequent drawdown literature emphasize time under water as a critical dimension of investor experience. Recent pension-fund simulations continue to show that limiting maximum drawdown materially shortens recovery and improves terminal outcomes for long-horizon investors.
3. See the companion papers *Dynamic Risk Budgeting*, *Adaptive Allocation: Aligning Portfolio Exposure with Changing Market Conditions*, and *Return Stacking: Expanding the Sources of Portfolio Return Through Capital-Efficient Investing*, as well as the firm's *Investment Policy Addendum on Pre-Committed Adjustment Rules*.
4. Kahneman & Tversky (1979) remain foundational on loss aversion. The practical implication for portfolio design is that process which reduces the size of losses the client must endure also reduces the probability of plan abandonment under stress.
5. Resilience-oriented design is not a guarantee of higher returns or of the absence of loss. It is an attempt to shape the distribution of outcomes so that the left tail is thinner and recovery periods are shorter. All investing involves the risk of loss.

References

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