RETURN STACKING

Expanding the Sources of Portfolio Return Through Capital-Efficient Investing

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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.

Most portfolios treat capital as a scarce resource that must be divided among competing return sources. Return stacking begins from a different premise: with capital-efficient instruments, additional return streams can be layered onto a core portfolio without fully displacing it.

1. The Constraint of Traditional Capital Allocation

In a conventional portfolio, every dollar can be allocated only once. An investor who wants equity exposure, bond exposure, and alternative risk premia must divide capital among them. Increasing the weight of one sleeve requires reducing the weight of another. The result is a permanent trade-off: more diversification often means less of the primary growth engine.

This zero-sum structure is so familiar that it is rarely questioned. Yet it is not a law of markets. It is a consequence of funding every exposure with the full notional amount of capital. When exposures can be obtained with only a fraction of the capital they control – through instruments that embed leverage at the instrument level rather than at the portfolio level – the zero-sum constraint loosens.

Return stacking is the deliberate use of capital-efficient instruments to place additional, diversifying return streams on top of a core allocation without requiring a one-for-one reduction in that core. The objective is not to maximize leverage. It is to expand the set of independent return sources the portfolio can access while remaining inside a pre-defined risk budget.[1]

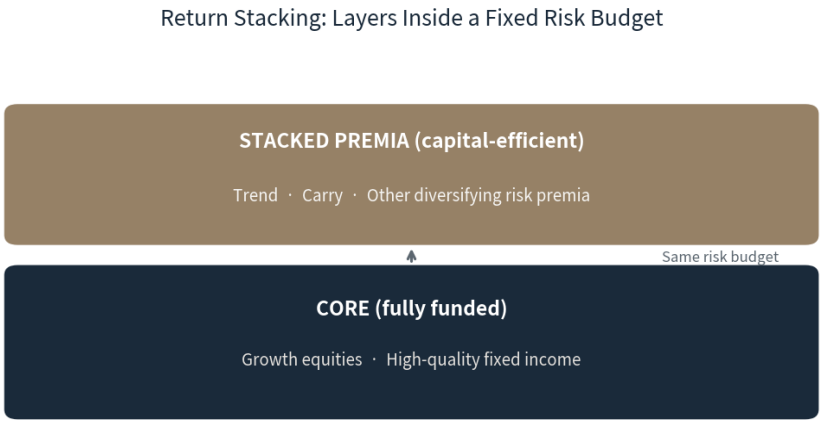

Exhibit 1. Stacked premia sit on a fully funded core inside a single risk budget.

2. What Return Stacking Is – and Is Not

Return stacking is the practice of combining a fully funded core portfolio (typically equities and high-quality fixed income) with one or more additional return streams that are obtained through capital-efficient vehicles. Because those vehicles require only a fraction of the notional exposure in cash, the residual capital can remain

invested in the core. The result is a portfolio that retains most or all of its original growth and ballast exposures while adding independent sources of return.

Three clarifying distinctions matter:

- **Stacking is not the same as portable alpha.** Portable alpha typically replaces a passive beta with an active overlay. Return stacking seeks to keep the core beta and add diversifying premia alongside it.

- **Stacking is not unconstrained leverage.** Every stacked exposure is sized inside an explicit risk budget. The total portfolio risk remains intentional and subject to the same regime-aware adjustment rules that govern the rest of the architecture.

- **Stacking is not a product category.** It is a portfolio-construction principle. The specific instruments used – futures-based funds, total-return vehicles, or other liquid capital-efficient structures – are means, not ends.

In the language of Dynamic Risk Budgeting, return stacking is a method for increasing the number of independent risk premia that can be included within a given risk budget. Capital efficiency becomes a tool of diversification rather than a tool of amplification.[2]

3. Capital Efficiency and the Risk Budget

The practical power of return stacking lies in the relationship between capital weight and risk contribution. A traditional 10% allocation to a strategy that has equity-like volatility contributes roughly 10% of portfolio capital and a meaningful share of portfolio risk. The same economic exposure obtained through a capital-efficient vehicle may require only 2-4% of portfolio capital while contributing a comparable amount of risk. The residual capital remains available for the core portfolio or for additional stacked exposures.

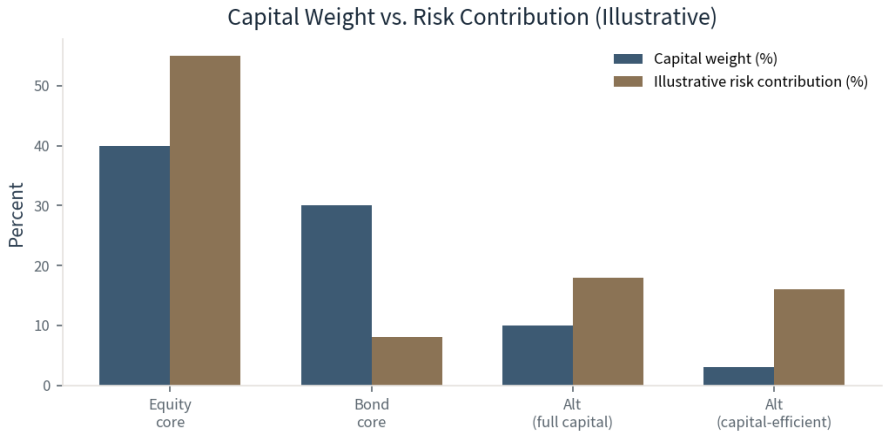

Exhibit 2. Illustrative capital weights versus risk contribution. Capital-efficient alternatives can deliver similar risk with far less cash.

This does not eliminate risk. It changes the unit of account. Risk is budgeted in units of expected volatility and expected shortfall, not solely in units of capital. The investor decides how much total risk the portfolio is designed to take, then decides how that risk is distributed across independent return streams. Capital efficiency simply expands the menu of streams that can be included without exhausting the budget.

Within the 40/30/30 architecture, return stacking is most naturally applied inside the liquid alternatives sleeve. Rather than funding every alternative strategy with full notional capital, the sleeve can use capital-efficient vehicles to obtain trend, carry, or other diversifying premia while leaving more of the sleeve's capital available for additional independent exposures or for cash buffer. The equity and fixed-income sleeves remain fully funded and continue to serve their primary roles as growth engine and ballast.[3]

4. A Simple Illustration

Consider a $1,000,000 portfolio that already holds a fully funded core of equities and high-quality fixed income. The investor also wants $100,000 of economic exposure to a diversifying alternative strategy that has equity-like volatility.

Traditional approach. Funding the exposure with full notional capital requires a $100,000 allocation (10% of the portfolio). That $100,000 must come from reducing the core. The investor gains the alternative exposure but permanently gives up $100,000 of equity or bond capital.

Capital-efficient approach. The same $100,000 of economic exposure is obtained through a liquid, capital-efficient vehicle that requires only about $25,000-$40,000 of cash (2.5%-4% of the portfolio). The remaining $60,000-$75,000 stays invested in the core. The portfolio now holds its original growth and ballast exposures plus the diversifying premium.

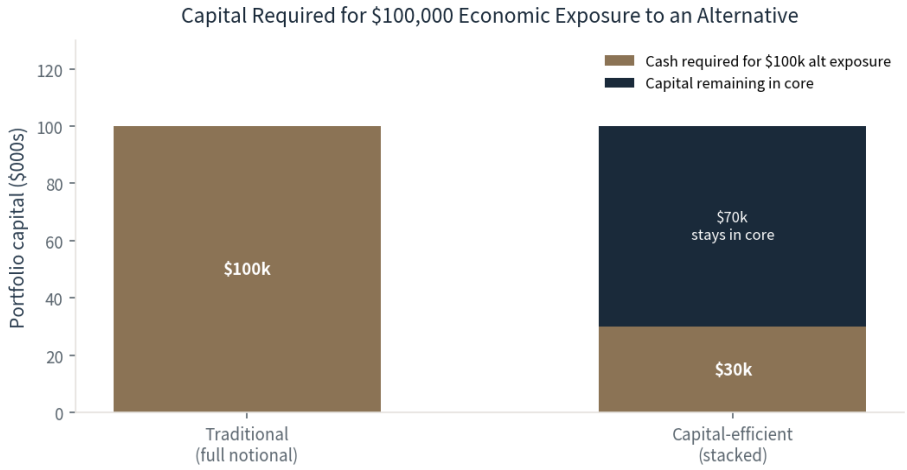

Exhibit 3. Capital required for $100,000 of alternative economic exposure (illustrative midpoint for the efficient case).

The risk contribution of the alternative exposure is comparable in both cases. What changes is the capital required to obtain it. Return stacking uses that difference to expand the set of return sources inside the same risk budget – not to increase total risk beyond the budget.

This illustration is conceptual. Actual capital requirements, risk contributions, and vehicle structures vary. All stacked exposures remain subject to the firm's risk-budget parameters and judgement-driven adjustment rules.

5. Integration with Adaptive Allocation

Return stacking does not override the regime-aware adjustment process. It operates inside it. When regime indicators signal elevated tail risk, the equity risk budget is reduced and the protective orientation of the alternatives sleeve is increased – consistent with the firm's judgement-driven adjustment process. Stacked exposures that contribute equity-like risk are subject to the same reduction discipline. Stacked exposures that are designed to exhibit low or negative correlation to equities during stress may be maintained or even increased within the alternatives sleeve, consistent with the Defensive regime stance.

The sequence is deliberate: risk budget first, capital efficiency second. Return stacking expands what can be held inside a given risk budget; Adaptive Allocation determines when that budget itself should be tightened or restored. The two mechanisms are complementary, not competing.[4]

5. Implementation Guardrails

Because capital efficiency involves instruments that embed leverage, the implementation standards are non-negotiable:

- **Liquidity.** Every stacked vehicle must offer daily or near-daily liquidity with transparent pricing and no material gates.
- **Transparency.** Holdings, strategy, and the degree of capital efficiency must be observable. Black-box leverage is incompatible with risk budgeting.
- **Risk budgeting over capital budgeting.** Exposures are sized by contribution to portfolio volatility and expected shortfall, not by the cash margin they require.
- **Bounded total leverage.** The aggregate notional exposure of the portfolio is capped relative to capital. The precise cap is set in the Investment Policy Statement and is not exceeded under any regime.
- **Regime subordination.** Stacked exposures remain subject to the same judgement-driven adjustment process. Capital efficiency does not create an exception to the Defensive regime.

6. Relevance for Substantial Capital

For clients with investable assets of $1 million to $10 million, the practical question is not whether return stacking can be implemented at institutional scale. It is whether liquid, transparent vehicles now exist that allow a similar principle to be applied at private-client scale without sacrificing liquidity or transparency. Increasingly, the answer is yes.

The value proposition is specific. A client who needs equity growth, bond ballast, and genuine diversification often faces a capital constraint: funding all three at full notional leaves the portfolio under-diversified or under-allocated to growth. Capital-efficient access to selected alternative premia relaxes that constraint inside a disciplined risk budget. The result is not a promise of higher returns in every environment. It is a more complete use of the risk the client has already decided to take.

This is consistent with the firm's broader architecture. Dynamic Risk Budgeting sets the risk capacity. Adaptive Allocation adjusts that capacity across regimes. Return stacking expands the set of independent return sources that can be held inside the capacity that remains.[5]

7. Conclusion

Return stacking is a portfolio-construction principle, not a product. It begins from the observation that capital is often the binding constraint on diversification, and that capital-efficient instruments can loosen that constraint without abandoning risk discipline. When applied inside an explicit risk budget, subject to regime-aware judgement-driven adjustments within pre-defined parameters, and limited to liquid, transparent vehicles, stacking becomes a method for expanding the sources of portfolio return rather than a method for amplifying risk.

For clients whose capital is substantial and whose decisions carry lasting consequences, the relevant question is whether the portfolio is making full use of the risk it is designed to take. Return stacking is one practical answer to that question – and one practical expression of fiduciary care.

Notes

1. The conceptual foundation of combining fully funded beta with capital-efficient overlays has deep roots in institutional portfolio construction, including the portable-alpha literature and the use of futures to obtain equity and bond exposure while freeing capital for active strategies. Return stacking, as used here, emphasizes the retention of core beta alongside added diversifying premia rather than the replacement of beta with alpha.

2. This framing is consistent with the Dynamic Risk Budgeting framework set out in the companion paper of the same name. Risk is the scarce resource that is budgeted; capital efficiency is a means of allocating that risk across a broader set of return streams.

3. The principle that risk contribution, not dollar weight, is the correct sizing lens for alternatives is reinforced by recent practitioner research (e.g., Vanguard, 2026). Capital-efficient vehicles make that principle operational by decoupling the cash required from the economic exposure obtained.

4. See the companion paper Adaptive Allocation: Aligning Portfolio Exposure with Changing Market Conditions, for the regime classification, equity risk-budget parameters, and restoration guidelines that govern all exposures, including stacked ones.

5. Return stacking is not a guarantee of higher returns or lower risk. It is a construction technique whose outcomes depend on the quality of the stacked premia, the discipline of the risk budget, and the discipline with which the adjustment process is followed. All investing involves the risk of loss.

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