Canadian Investors: Recreate Warren Buffett's 90/10 Portfolio With These 2 BMO ETFs

Description

I don't think Warren Buffett needs any introduction. Quite simply, he is arguably the most successful value investor and stock picker in history, with a long track record of outperforming the market handily.

However, rather than trying to find undervalued stocks, Buffett has advised that the masses keep it simple and just invest passively in an **S&P 500** index fund. Buffett loves the index as a hands-off, low-cost method for building wealth.

Buffett's strategy

In a 2013 letter to **Berkshire Hathaway** shareholders, Buffett indicated that upon his passing, the trustee of his estate will invest 90% of his wife's inheritance in a low-cost Vanguard S&P 500 Index Fund, and the other 10% in short-term U.S. treasury bonds. That's quite a departure from Berkshire's portfolio of hand-picked value stocks!

Make no mistake, this is a risky portfolio that can have volatile movements along with the rest of the market. Most of the risk here is still being contributed by the 90% stocks, with the 10% bonds not doing much to offset volatility. I think Buffett sees that 10% as a safer parking garage for his massive cash fortune — his wife could live off that alone indefinitely.

However, the portfolio does quite well for investors with a long time horizon and even holds up during the retirement withdrawal phase. Javier Estrada, professor of finance at the IESE Business School in Barcelona, Spain, found that Buffett's 90/10 asset allocation works well with a 4% withdrawal rule. Looking at rolling 30-year intervals, Estrada found that Buffett's portfolio had a low failure rate of 2.3%, which was comparable to the traditional 60/40 portfolio.

Which ETFs should you use?

Investors looking to implement Buffett's 90/10 portfolio can convert currency and buy USD-listed ETFs in their RRSPs. This grants access to the funds of his choice and saves you 15% on the foreign withholding tax imposed on non-Canadian dividends.

However, if you're looking for a simple solution without the hassle of currency conversion, using Canadian-listed ETFs is fine too. You're sacrificing a smidgen of tax efficiency for simplicity, which I think is always worth it. Don't let the tax tail wag the dog, as they say.

For the equity portion, investors can buy **BMO S&P 500 Index ETF** (TSX:ZSP), which costs a low management expense ratio (MER) of 0.09%. For the bond portion, investors can buy **BMO Short-Term Federal Bond Index ETF** (TSX:ZFS) as a substitute for short-term U.S. Treasuries for a 0.22% MER.

To make a Canadian version of Buffett's portfolio, hold these two ETFs in a 90/10 allocation with dividends reinvested and annual rebalancing. ZSP will be driving most of your returns, allowing you to match 90% of the S&P 500's total return, while VSB reduces volatility slightly and allows you to park some cash to buy dips with.

The Foolish takeaway

The Warren Buffett 90/10 portfolio is an extremely simple, low-cost, and easy to implement investment strategy. I expect it to outperform the majority of stock pickers and actively managed funds out there.

However, it could be optimized further. Personally, I would prefer more of an allocation to long-term U.S. Treasuries, small-cap value stocks, and international stocks for lowered volatility and improved risk-adjusted returns.

Then again, who am I to argue against Buffett's advice?

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2. TSX:ZSP (BMO S&P 500 Index ETF)

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