

The Strategy as an Insurance Policy: An Options Lens

The 1% drag is the premium; the drawdown cut is the payout

I have written before that the strategy has, over the long haul, earned about one percent a year less than a plain balanced fund, while cutting the worst drawdowns roughly in half. A sharp reader might ask: is there a rigorous way to think about that trade? There is, and it comes from the world of options.

The premium and the payout

The strategy is not free downside protection — nothing is. The honest framing is this: **I accept roughly a one percent annual performance drag in exchange for reducing large drawdowns by about half.** In the language of options, that one percent a year is the premium. The drawdown reduction is the insurance payout.

The trick is that the 200-day rule is not literally buying put options. It is a path-dependent, rules-based, synthetic insurance program. Think of a normal balanced fund as the unhedged portfolio. The strategy is like owning that portfolio plus a rolling protective overlay that cuts exposure when the trend breaks.

A strange sort of option

If you tried to describe the overlay to an options trader, you would need several contracts at once. It behaves like a *protective put*, because it helps after markets fall. Like a *stop-loss*, because it exits when price breaks below the trend line. Like a *barrier option*, because the hedge only activates after a trigger. Like *lookback protection*, because what it guards against is large peak-to-trough damage. And like a *dynamic hedge*, because the exposure changes over time, sector by sector.

Why does this matter beyond the analogy? Because real portfolio insurance — actually buying puts year after year — is notoriously expensive, often costing several percent annually for meaningful protection. A rules-based trend overlay has historically delivered a comparable kind of crash protection for a much smaller premium, paid not in cash but in whipsaws and lag during choppy or fast-recovering markets.

What the premium buys, and what it does not

Like any insurance, you should expect to pay the premium most years and collect rarely. In the long bull stretches the drag is real and visible — that is the premium leaving the account. In 2008, when the market fell 55 percent and the strategy fell about 15, the policy paid out. In fast V-shaped crashes like 2020, the protection helps on the way down but gives back part of the rebound — a deductible, if you like.

So the fair description is this: the 200-day moving average rule behaves like a low-cost, rules-based portfolio insurance program. It does not eliminate losses, and it can lag in choppy markets, but historically it has exchanged a modest annual return drag for a meaningful reduction in severe drawdowns. Whether that policy is worth holding depends on how much a 50 percent drawdown would change your life. For a 30-year-old with a paycheck, maybe not much. For someone living on their portfolio, quite a lot.

— John