GYROSTAT
CAPITAL MANAGEMENT

The hidden assumption in most portfolios: Stability

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Markets do not usually fail portfolios.
Assumptions do.

Most portfolios are built with care, diversification and good intent. Many perform well for long periods. Yet when they fail, they tend to fail in similar ways — not because markets behaved unexpectedly, but because the conditions those portfolios quietly relied upon did not persist.

Stability is rarely stated as an objective. It is simply assumed.

Stability is assumed, not tested

Every portfolio is built on a set of implicit assumptions. They are seldom written down, but they shape outcomes.

Among the most common are assumptions that:

- correlations remain broadly stable,
- liquidity is available when required,
- volatility is temporary and mean-reverting,
- time is available for recovery.

These assumptions are not unreasonable. They often hold for long stretches. The problem is not that they exist, but that portfolios are rarely designed for the possibility that they fail simultaneously.

Stability is not declared in portfolio construction. It is embedded by default.

Correlation is conditional

Diversification is one of the most trusted principles in investing. It works — until it matters most.

Correlations are not constants. They are state-dependent. During periods of stress, assets that normally behave independently often begin to move together. This is not a failure of diversification; it is a feature of market behaviour under pressure.

History offers repeated reminders. In periods of systemic stress, the benefit of diversification compresses precisely when protection is needed most.

For accumulators with long horizons, this compression may be uncomfortable but survivable. For retirees or investors approaching retirement, it can be outcome-altering.

Liquidity is not a permanent feature

Liquidity is often treated as a constant. In reality, it is conditional.

Markets are liquid when:

- participants are willing to transact,
- balance sheets can expand,
- price discovery is orderly.

During stress, these conditions change. Bid–ask spreads widen. Market depth thins. Selling becomes price-setting rather than price-taking.

Portfolios designed around *paper liquidity* can struggle in practice. Forced selling — driven by drawdowns, redemptions or risk controls — often occurs at the worst possible time.

For investors drawing regular income, liquidity failure is not theoretical. It is immediately visible in cash flows and portfolio sustainability.

Volatility is not the real risk

Volatility is observable and measurable. For that reason, it often becomes the proxy for risk.

But volatility itself is rarely the problem. The real risks lie in:

- the depth of drawdowns,
- the timing of losses,
- the shape of the recovery path.

Portfolios that appear smooth can still be fragile if they rely on leverage, liquidity, or structural assumptions that only hold in benign conditions. Apparent stability can mask embedded risks that emerge suddenly under stress.

Measured calm is not the same as functional resilience.

Time horizon changes everything

Time is the most underappreciated variable in portfolio design.

Accumulating investors can often afford to wait. Retirees cannot. Early losses in retirement permanently alter outcomes by reducing capital available for income, increasing behavioural pressure, and limiting future flexibility.

This is the practical reality of **sequencing risk**: when early losses occur, income sustainability and longevity planning are altered permanently.

A portfolio that is mathematically sound can still be functionally broken if it cannot support income needs through adverse early outcomes.

What happens when assumptions fail

When stability assumptions fail, the consequences are predictable:

- diversification weakens,
- rebalancing becomes difficult,
- risk budgets are breached,
- behaviour overrides process.

These are not market failures. They are design failures.

They arise not from a lack of forecasting skill, but from portfolios that were not built to function when their underlying assumptions stopped holding.

From hidden assumptions to explicit design

The question for advisers and asset owners is not whether markets will eventually stabilise. History suggests they usually do.

The more important question is whether portfolios are designed to remain functional while stability is absent.

For retirees, these failures do not show up as volatility statistics. They show up as disrupted income, reduced optionality and increased reliance on hope rather than process.

Risk management begins by making assumptions explicit — and designing portfolios that do not depend on their continued validity.

Results as confirmation

Strong long-term outcomes are not achieved by consistently predicting when instability will occur. They are achieved by ensuring portfolios remain resilient when it does.

When portfolios are designed to function without relying on stability, certain structural features tend to matter: persistent downside protection, income resilience, and the ability to benefit from volatility rather than fear it.

Gyrostat Risk Managed Equity Fund Classes A & B have downside protection always in place, regular income, with returns in rising and falling markets including large market falls.

The leveraged Class B Units have a focus on greater returns and less risk protection.

These features are responses to failed stability assumptions, not forecasts.

These returns are non correlated with the market providing portfolio diversification benefits such as lower risk, higher risk-adjusted returns, and reduced exposure to market shocks.

Consistent returns all market conditions

Class	1 YR	2 YR p.a.	3 YR p.a.	4 YR p.a.	Max Quarterly Loss	Beta #
Class A – Australian Equity Absolute Return (AUD)	+8.29%	+8. 92%	+8.03%	+10.82%	-0.52% (past 3 years)	-0.08
Class B – Australian Equity Absolute Return (AUD)	+9.89%	+9.31%	+9.33%	+13.94%	-0.84% (past 3 years)	-0.10

Performance as at 31 December 2025 *# 3 yr XJO Beta*

Closing thought

Stability is comfortable, familiar and often prolonged. But it is not guaranteed.

Portfolios that assume stability may perform well for long periods. Portfolios that are designed to function without it tend to matter most when outcomes are irreversible.
