

## **When Does The 1/N Rule Work?**

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The 1/N rule provides a simple way to obtain a diversified portfolio. Studies have shown it often outperforms more sophisticated approaches. We show that the 1/N rule only outperforms an optimal portfolio in two out of seven major equity markets: the USA and Japan. We develop a market-specific measure that indicates when the 1/N rule will dominate. Our measure is based on the distance between the 1/N portfolio and the maximum Sharpe ratio portfolio. We label it the 1/N favorability index. The 1/N rule also does well when the market as a whole performs well and we analyze the joint contribution of this factor and the favorability index. This is a joint work with Danqiao Guo, Phelim Boyle, and Tony Wirjanto.