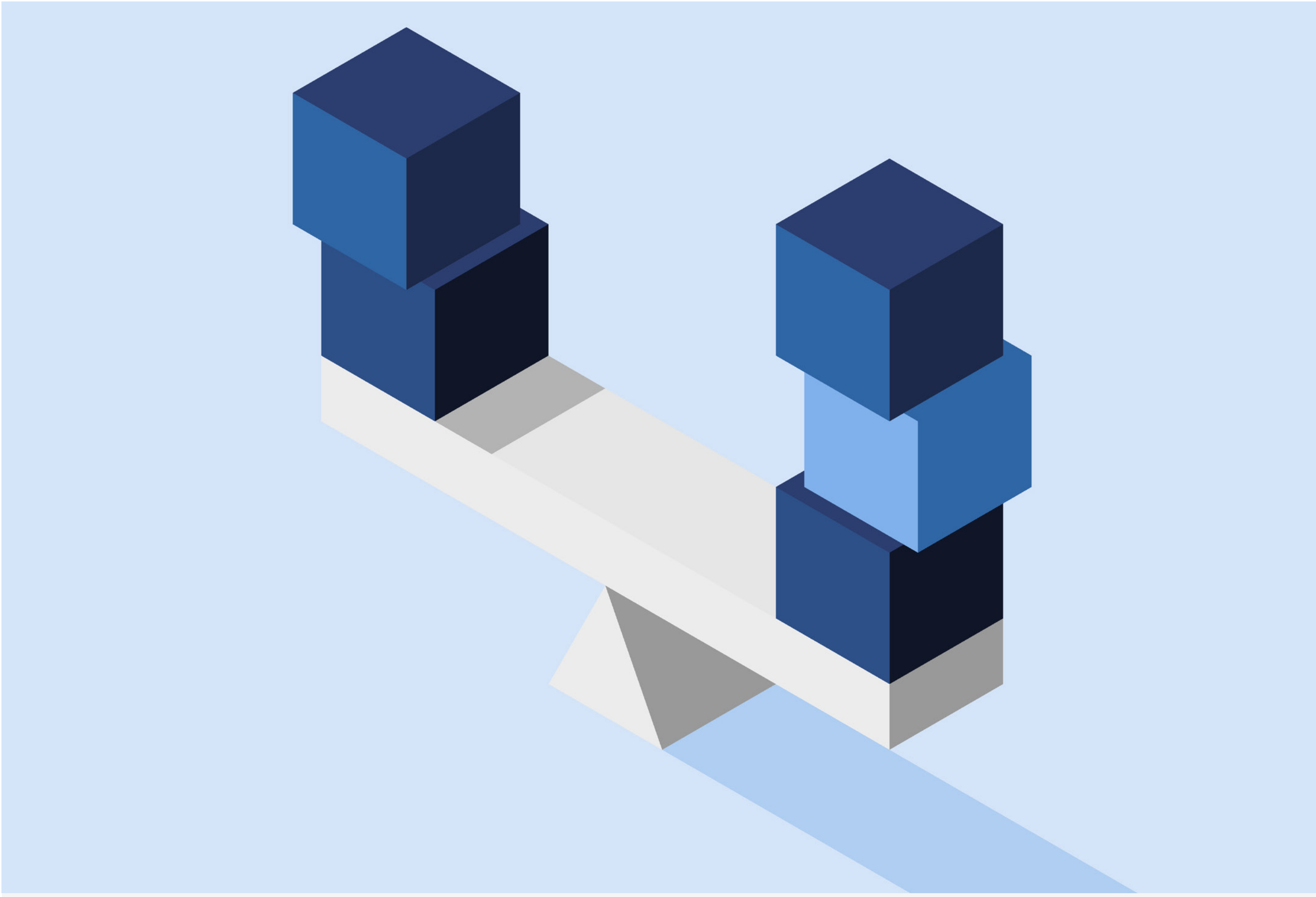

No Turning Back: 60/40 Is Out, Is Your Portfolio Ready?

Investors today have expanding investment choices, but what does that mean for building a portfolio that can weather the natural ups and downs of the market?

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The 60/40 portfolio allocation of stocks to bonds is one of the most traditional and widely followed investment strategies. Its reputation is built on offering moderate investors enough steady growth and stable income to meet long-term goals. But in recent years, numerous articles have been written about the death of the 60/40 portfolio. Many argue that the model puts investors in a precarious position going forward, based on today's market environment. Unfortunately, far fewer articles offer a roadmap on what the future of portfolio construction looks like.

Historically, investors have allocated towards bonds to diversify equity risk, a time-tested strategy. In the past, bonds have rallied into equity market dislocations as investors gravitated towards more stable assets in times of market stress. Today though, there is a new reality for investors and the advisors who serve them.

As of March 1, the 10-year U.S. Treasury yields 1.70% and the 30-year U.S. Treasury yields 2.10%.[I] Even for investors willing to take on corporate credit risk, the returns aren't much better—take the Moody's Seasoned Aaa Corporate Bond yield at 3.20%.[II] Against a backdrop of 7.5% annual inflation,[III] these instruments provide limited upside. Furthermore, traditional fixed income investments may lose value if rates move up meaningfully—a justifiable fear for many investors in light of widely anticipated rate hikes from the Federal Reserve.[IV] A possible stagflation scenario could lead to both bonds and equities losing value. In today's markets, the "40" certainly may not provide the same hedge to the "60" that it used to.

So, what opportunities exist, and where do I start?

Much like when I try to improve my golf game by analyzing the pros' swing mechanics, a good place to start is with the professionals, in this case, institutional money managers. By looking at how the professionals operate, I can start to assess how to emulate their strategy—whether I aim to improve my golf swing or my portfolio's performance.

Today, many pensions and endowments have alternative investment allocations in their portfolios of roughly 26% and 51%, respectively. Individual investors, on the other hand, are allocating a mere 5% to alternatives.[V] Such a large discrepancy may have something to do with the success and simplicity of the 60/40 portfolio, but is also likely a function of historically limited access to information about the alternatives space, especially for individual investors. The latter is changing, and investors today have expanding choices to diversify a portfolio.

While alternatives are not for every investor, those with a trusted advisor who can help navigate the current landscape should explore the possibilities. Alternative investments are simply those that fall outside the realm of traditional assets like stocks, bonds, and cash. Some types of alternative investments include venture capital, private equity, interval funds, and hedge funds along with alternative credit, real estate investment trusts, liquid alternatives, and digital assets. These broad categories encompass an array of strategies and can be used across the asset allocation to pursue diverse objectives like growth, uncorrelated returns, portfolio protection, and income enhancement—timely concepts given today's market challenges.

Investment managers in the alternatives space often have more flexibility around executing a business plan (including greater use of leverage) and less constraints with respect to their timing and exit strategies. With this increased flexibility comes risks such as a lack of liquidity and/or longer lock-up periods, higher fees, and the potential for significant loss. A critical part of the process is finding an experienced investment manager with a proven track record, and ensuring you understand and are comfortable with the risk considerations.

Risk-managed solutions are another way to get proactive with your portfolio in today's markets. For instance, both structured investments and annuities can help fine-tune your market exposure to meet growth or income needs. A structured investment is linked to an underlying asset, such as an equity index or ETF. It delivers tailored risk, meaning it can provide downside protection against a market decline and even cap a financial loss while simultaneously offering some upside participation (or coupon) in the underlying market. Annuities are well known for being able to offer tax-deferred growth, principal protection, and lifetime income. Like structured investments, there are annuity solutions scattered across the risk-return spectrum, such as fixed annuities with guaranteed rates, or fixed indexed and structured annuities that give additional upside potential while taking on some risk. Like with alternatives, it is important to be comfortable with risks associated with structured investments and annuity products, which may include issuer credit risk or the claims paying ability of the carrier, limits on upside participation, potential for loss, and limited liquidity—so make sure to read a product's offering document before investing.

If we've learned anything during the pandemic and into the start of 2022, it's to strive for a comfortable risk-reward balance across the portfolio while staying present for opportunities in evolving markets. There is a huge window of opportunity for education around newer and less understood investment types, and the timing to get up the curve with alternative investments and risk-managed solutions seems ideal. Factor in lower real return expectations for a 60/40 portfolio over the next 5-10 years (perhaps as low as 2% per annum),[VI] and investors have all the fuel they need to look beyond the 60/40 box for returns and risk management as they ask themselves: "Is my portfolio ready?"

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I U.S. Treasuries, as of 03/01/22. See cnbc.com/bonds
II Moody's Seasoned Aaa Corporate Bond Yield, as of 03/01/22. See Ycharts.com
III Consumer Price Index News Release, as of 02/10/22
IV Federal Reserve Bank of Atlanta Market Probability Tracker, as of 03/01/22
V Seeking an Alternative: Understanding and Allocating to Alternative Investments, Blackstone, 2021
VI Alternative Thinking Q1 2022: Capital Market Assumptions for Major Asset Classes, AQR, 2022

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