CLEARPOINT

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IS THERE A FUTURE FOR THE CONVENTIONAL 60/40 INVESTMENT PORTFOLIO?

BY HALEY J. SCHUBERT, CFA, PORTFOLIO MANAGER

“Balanced,” “60/40,” “Moderate”—these are all ways to describe an investment portfolio invested 60% in stocks and 40% in bonds. The goal of the portfolio is to “balance” portfolio returns in any given year, as bonds and stock prices have historically been negatively correlated. Record low interest rates have sparked debate on the benefits of a balanced portfolio, warranting a closer look at the conventional portfolio.

HISTORY OF THE BALANCED PORTFOLIO

To evaluate the success of the balanced portfolio, we look to segment different time periods in history. From 1980 to 2010, the average return of the S&P 500 and Bloomberg Aggregate was 13% and 9%, respectively. Comparatively, from 2011 to 2021, the S&P 500 returned an average of 16% annually, while the Bloomberg Aggregate returned only 3%. Interestingly, average balanced portfolio returns were rather similar for both time periods, but low interest rates shifted the contribution of total return within the equity and bond allocations. While the bond allocation in balanced portfolios is 40%, it has contributed only 13% of total returns, on average, since 2010.

CLEARSTEAD CONTINUES TO BOLSTER TEAM WITH NEW TALENT

We are pleased to announce that we have added talent to the Private Client and Institutional Consulting teams with Alexandra Bair and Gareth Hannigan.

Alexandra Bair joined Clearstead as a Client Service Associate, PCG. Alexandra previously worked as a Consultant at New York Life supporting Annuity Services. She has a BA from Cleveland State University.

Gareth Hannigan joined Clearstead as a Client Service Associate, ICG. Gareth has previous experience as an Investment Processor/Liaison and Relationship Manager at Equity Trust.

These changes underscore the firm’s commitment to building its investment consulting practice, promoting the next generation of leadership, and maintaining a rigorous investment process.

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Time Period	Average Annual S&P Return	Average Annual Bloomberg Agg Return	Average Annual 60/40 Portfolio Return	Equity Contribution	Bond Contribution
1980-1989	18%	13%	16%	68%	32%
1990-1999	19%	8%	15%	78%	22%
2000-2009	1%	6%	3%	22%	78%
2010-2019	14%	4%	10%	85%	15%
2020-Present	14%	0%	8%	98%	2%
2022-2031*	6%	2%	4%	85%	15%

Source: Bloomberg and Clearstead Investment Office.

**Expected returns are based on Clearstead's 2022 Capital Market Assumptions, 10-Year forward looking returns.*

Forecasted returns (2022-2031) are based on assumptions created by Clearstead. Clearstead is making no representations that the forecasted returns will or can be achieved. Furthermore, Clearstead is not liable for decisions made using this information. Past performance is not an indicator of future results.

The average 10-year treasury yield from 1980 to 2010 was +7% with yields topping 15% in 1981.[1] The below chart highlights the calendar years of 1980-2010, where the S&P 500 experienced negative returns and the associated performance across markets. In this period, the bond allocation provided significant income above equity yields, while also providing principal protection and diversification to the balanced portfolio. The power of the balanced portfolio was clear during this time period—negative equity returns were partially offset by positive bond market returns, moderating annual portfolio returns for investors.

Year	Annual Return S&P 500	Annual Return Bloomberg Agg	Annual Return 60/40 Portfolio	10-Year Treasury Yield
1981	-4.92%	6.25%	-0.45%	14.00%
1990	-3.16%	8.96%	1.69%	8.50%
2000	-9.03%	11.63%	-0.77%	6.00%
2001	-11.89%	8.43%	-3.76%	5.00%
2002	-22.10%	10.23%	-9.17%	4.50%
2008	-37.00%	5.24%	-20.10%	3.50%

Source: Bloomberg.

Past performance is not an indicator of future results.

STOCKS AND BONDS: A VARIABLE RELATIONSHIP

The relationship between stocks and bonds can be seen over time through the correlation of returns. Correlation is a statistic that measures how two securities move in relation to each other. Correlation values range from -1 to 1. A correlation of negative one (-1) shows an inverse relationship, zero signifies no relationship, and positive one (1) means they move identically. As seen in the chart on the next page, throughout the 1980s and 1990s, the rolling 48-month correlations are significantly greater than zero, exhibiting positive correlations for the asset classes. Correlations turned negative with the market weakness following the Tech Bubble ('00) and The Great Recession ('08). Both time periods were characterized by sharp declines in the equity markets and a bond market rally as investors flocked to safety. The shift in this relationship can be seen from market behavior following the last bear market in March 2020 and the onset of the COVID-19 Pandemic. Why do we not see a negative correlation as was prevalent in previous market corrections? The answer is likely historically low interest rates. The 10-Year Treasury Yield in 2000 and 2008 was 4x and 2x higher, respectively, than the 1.5% 10-Year Treasury Yield in February 2020.[1] Historically, low interest rates limit the potential for a bond market rally under stressed equity market conditions, as interest rates can only go so low; US 10-Year treasury yields have never traded in negative territory.[1] The higher bond yields prevalent in the previously-mentioned market corrections worked to cushion investors in a balanced portfolio.

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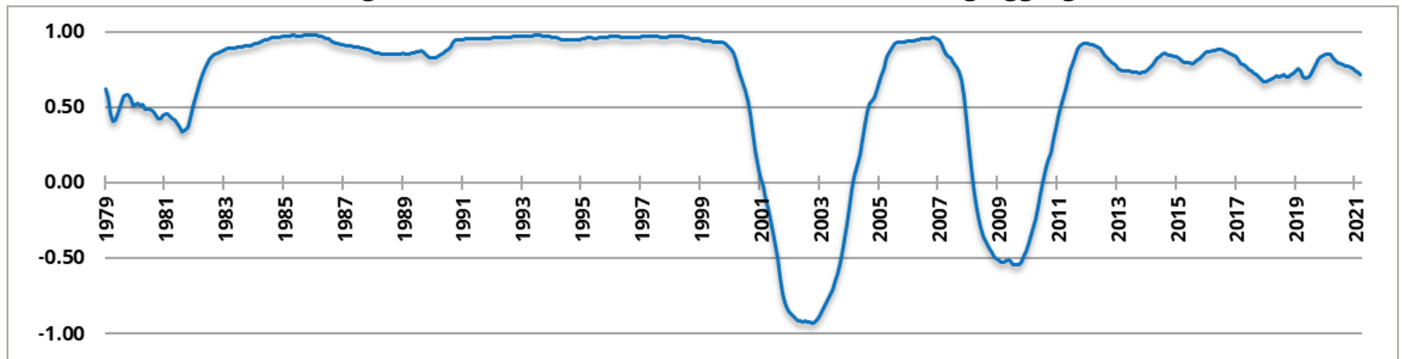
Rolling 48 Month Correlations: S&P 500 & Bloomberg Aggregate



Source: Bloomberg.

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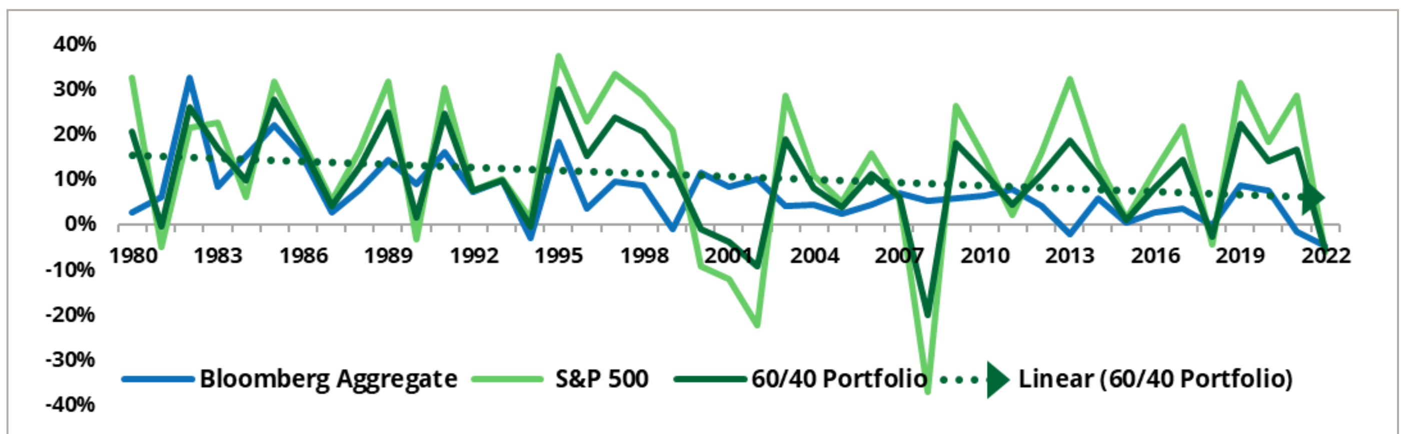
FIRST QUARTER 2022

Fast forwarding to this year, the first quarter ended in negative territory for both the equity and bond markets. This is a rare occurrence, as we have only seen negative returns for the S&P 500 and Bloomberg Aggregate in the same quarter 7 times over the past 120 quarters (30 years!).[1] Given the drawdown we have seen this year in the bond market, the chance we experience a second year of negative bond returns outweighs the alternative. Our expectations for the Federal Reserve's tightening cycle to combat inflation result in negative capital market expectations for the bond market this year. The current yield on the Bloomberg Aggregate is not sufficient to offset the principal loss in price from the expected rise in interest rates. With the Bloomberg Aggregate declining -5.9% through the end of the first quarter, the bond allocation in balanced portfolios did not work to moderate returns for investors who were simultaneously experiencing negative equity returns for the quarter.[1]

FUTURE OF THE BALANCED PORTFOLIO; "ALTERNATIVES" AS AN ALTERNATIVE TO THE TRADITIONAL 60/40 PORTFOLIO

The future success of the balanced portfolio will depend on the future level of interest rates. Various market factors that have worked to keep interest rates historically low remain prevalent today, most notably demographics and the national debt. Looking back to 1980, the total return for the 60/40 portfolio is experiencing a downward trend. The bottom line is that, in order to generate comparable returns with stocks and bonds, investors will likely have to accept more equity risk.



Source: Bloomberg.

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When selecting the appropriate asset allocation, it is important to consider the necessary income, growth, diversification, and liquidity goals for a given investor. While these goals may have been historically met with a traditional stock and bond portfolio, positioning for the future will likely include introducing alternative assets into the portfolio. For qualified investors that can withstand the illiquidity characteristics, introducing private investments may be appropriate. Two main reasons we invest in alternative assets are for diversification and access to a broader opportunity set. Historically, introducing a 20% alternative allocation into a growth portfolio improved annual returns and lowered portfolio volatility as seen in the below chart. Additionally, investing in a broader opportunity set has become increasingly important in recent years as the number of public companies in the market has significantly declined.

January 1990 - March 2019

Portfolio	Historical Return	Historical Volatility
50% US Equity / 25% Int'l Equity / 25% Fixed Income	7.9%	10.9%
40% US Equity / 20% Int'l Equity / 20% Alternatives / 25% Fixed Income	8.3%	9.8%

Historical Return/Volatility: Source: Zephyr. Data from 01/01/1990 to 03/31/2019. Assumes Quarterly rebalancing.

US Equity – Russell 3000, Int'l Equity – MCSI All World xUS, Alternatives & Hedge Funds – HFRI Fund Weighted Composite Index, Fixed Income – Bloomberg Barclays U.S. Aggregate, Private Equity – Cambridge PE Index, Private Real Estate – NCREIF Property

Index, Public Real Estate – FTSE NAREIT All Equity REITs

Historical Return and Volatility was calculated using the static allocation for each index and its respective allocation during the time period shown. Returns and Volatility data are based on historical performance, which is not an indicator of future returns. Past performance is not an indicator of future results.

January 1990 - March 2019

Asset Class	Historical Return	Historical Volatility	Forecasted Return	Forecasted Volatility
Hedge Funds	9.7%	8.1%	6.0%*	6.2%*
Private Equity	14.4%	9.4%	10.4%	8.8%
Private Real Estate	7.4%	5.9%	9.7%	15.5%
US Large Cap Stocks	9.3%	15.3%	6.3%	14.0%

Historical Return/Volatility: Source: Zephyr. Data from 01/01/1990 to 03/31/2019. Assumes Quarterly rebalancing.

US Equity – Russell 3000, Int'l Equity – MCSI All World xUS, Alternatives & Hedge Funds – HFRI Fund Weighted Composite Index, Fixed Income – Bloomberg Barclays U.S. Aggregate, Private Equity – Cambridge PE Index, Private Real Estate – NCREIF Property

Index, Public Real Estate – FTSE NAREIT All Equity REITs

Forecasted Return/Volatility: Clearstead Investment Office 2022 Capital Market Assumptions, geometric 10-year forward expected returns. Hedge Funds – 50% HFRI Relative Value/ 50% HFRI Equity Hedge, Private Equity – Cambridge Associates US Private Equity, Private Real Estate– NCREIF Value Added, S&P 500 Index – Russell 1000 TR

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As we evaluate the current state of the economy and expectations for the future, we are adjusting portfolios to increase the income characteristics and the inflation sensitivity of portfolios—the combination of which is likely to result in increasing dividend yields and lower equity beta. As the world continues to experience lasting effects from the COVID-19 pandemic with record high inflation and historically low interest rates. Given the market environment and return expectations, the traditional 60/40 may no longer be appropriate to meet investor's goals and objectives for income, growth, and diversification.

Sources:
(1) Bloomberg.

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Performance data shown represents past performance. Past performance is not an indicator of future results. Current performance data may be lower or higher than the performance data presented.

MARKET BENCHMARK RETURNS

April 30, 2022		1M	3M	12M	YTD
US Large Cap	S&P 500	-8.7%	-8.2%	0.2%	-12.9%
US Small Cap	Russell 2000	-9.9%	-7.8%	-16.9%	-16.7%
Developed Intl	MSCI EAFE	-6.5%	-7.5%	-8.1%	-12.0%
Emerging Intl	MSCI Em Mkt	-5.6%	-10.5%	-18.3%	-12.1%
Real Estate	NAREIT	-4.0%	-1.5%	8.7%	-9.1%
Core Fixed	BarCap Agg	-3.8%	-7.5%	-8.5%	-9.5%
Short Fixed	BarCap 1-3Yr	-0.5%	-2.3%	-3.5%	-3.0%
Long Fixed	BarCap LT G/C	-9.3%	-15.1%	-13.8%	-19.2%
Corp Debt	BarCap Corp	-5.2%	-9.4%	-10.1%	-12.3%

Source: Bloomberg

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