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# THE DEATH OF THE 60/40 PORTFOLIO

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We had the pleasure of hosting Jared Woodard, Head of the Research Investment Committee for Bank of America Research, on our Behind the Markets podcast last week.

When we get to the other end of the pandemic, Woodard's team has three scenarios in mind for financial markets.

1. **Stagnation:** A path of low growth, wages, [interest rates](#) and profits for most companies and relatively few winners in the markets. This is the world of secular stagnation we have been in for the last decade or two.
2. **Stagflation:** One catalyst that could spark higher [inflation](#) with low growth might be a changing relationship with China, not just in the U.S., but around the world. It also could come from more regulation of the technology sector.
3. **Elevation:** A world of higher growth, higher productivity and maybe demand-based inflation (which is the good kind). If world leaders start investing more intentionally in capital expenditures and research and development, there are many examples in modern times of private and public sector partnerships that powered innovation higher. Many of the components of smartphones came from Cold War spending that led to long-run innovations. There would be nothing more [bullish](#) than this cooperation for new investments where we can see higher growth.

## The World Is Just One Trade Today

Whether it is [growth](#) versus [value](#), [large caps](#) versus [small caps](#), U.S. markets versus foreign markets or the drop in bond [yields](#), all things that are leading the market are correlated to the lack of profit opportunities and very narrow growth leaders. The risk to this market setup is if we have a breakout in inflation coupled with a growth surprise that would shake up the incredibly crowded and expensive assets and turn toward the real losers over the last two decades.

## The Death of the 60/40 Portfolio

The biggest takeaway is that Woodard's team is more confident than ever that we hit the low in interest rates this year and will likely see them move considerably higher in the future, arguing that investors should start to move away from bonds in their current allocations.

Woodard's team also believes the standard hedging function and diversification benefits of bonds will be much less attractive going forward. Right now, the [10-year U.S. Treasuries](#) are trading at 75 [basis points \(bps\)](#), while the market is pricing in inflation over the next 10 years at 1.7%. Investors are locking in real, after-inflation purchasing power losses and essentially buying bonds as "insurance" against an equity market decline.

## Expensive Insurance

To Woodard and his team, bonds have become expensive insurance against equity declines, particularly if bonds will no longer maintain their diversifying properties with these very low rates.

Treasuries can also become a source of risk in portfolios if we start to get inflation heading higher, combined with positive surprises on economic growth. The takeaway: There are better places to allocate capital than long-term bonds, and there are better ways to structure portfolios.

## Where to Put Risk Capital to Work

There are three types of risk in their simplest form: equity risk, credit risk and interest rate risk. The other two types of risk are more attractive than interest rate risk, and Woodard likes taking on some prudent credit risk.

This was a great conversation on the key challenges for most investors today. You can listen to the full conversation below.

Behind the Markets on Wharton Business Radio - Behind The Markets Podcast: Jared Woodard

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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## DEFINITIONS

**Interest rates** : The rate at which interest is paid by a borrower for the use of money.

**Stagflation** : a situation in which the inflation rate is high, the economic growth rate slows.

**Inflation** : Characterized by rising price levels.

**Bullish** : a position that benefits when asset prices rise.

**Growth** : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

**Value** : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

**Large-Capitalization (Large-Cap)** : A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

**Small caps** : new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

**Yield** : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

**10-Year Treasury** : a debt obligation of the U.S. government with an original maturity of ten years.

**Basis point** : 1/100th of 1 percent.