INVESTING IN A POST-60/40 MARKET REGIME

Scott Welch — Chief Investment Officer, Model Portfolios
01/30/2020

This article is relevant to financial professionals interested in model portfolios. WisdomTree ETF model portfolios are directly accessible only by financial professionals, through the WisdomTree website and various model portfolio platforms.

WisdomTree has collaborated with Wharton finance professor Jeremy Siegel for almost 20 years.

Professor Siegel is known for his long-term view on equities as the preferred way to grow assets.

But his recent research looks at the bond market, and challenges created by the income available from traditional fixed income assets.

Professor Siegel increasingly is convinced that interest rates may stay low for much longer than he had anticipated. Quite frankly, he does not see any particular catalyst for a rapid or unexpected rise in interest rates—for many years to come.

The investment implications may be profound.

In this new market environment, moderate risk investors—the typical 60/40 investors—will likely struggle to generate sufficient yield from their income portfolios to maintain their desired lifestyles.

To put it more bluntly, WisdomTree believes a 60/40 portfolio is not going to get the job done for many investors. This asset-class world view is complicated by long-term aging trends.

Longevity Is the *New Black*

Research from the MIT Age Lab[1] illustrates that we are living longer, and that longevity will increase as health science and technology continue to advance. Our wealth and financial plans need to evolve as well.

The income-focused retirement portfolios many investors have traditionally relied on may not be appropriate for the new retiree demographic characteristics.

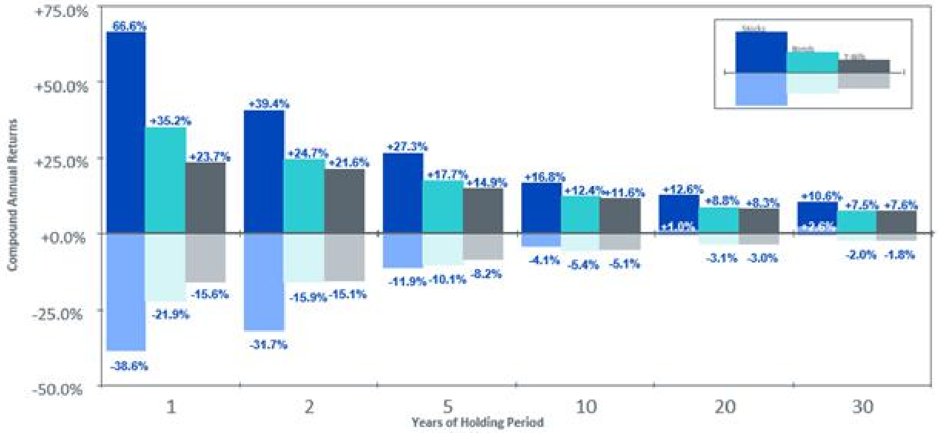
This requires us to redefine risk in long-term investment portfolios.

We have trained ourselves (and our clients) to define risk as the standard deviation of portfolio returns—a fancy way of saying short-term volatility risk.

But as investors live longer, we need to re-introduce another definition of risk: the risk of outliving your money.

This aligns with the main message from Professor Siegel's first book. The premise in *Stocks for the Long Run* is easy to understand—stocks may be volatile in the short term, but, as shown in figure 1, equities have outperformed all other major asset classes over full market cycles and through time. They have done so with more stable, consistent, and less volatile returns than bonds at 20-30 year time horizons.

Maximum and Minimum Returns 1802–2019



Source: Siegel, Jeremy, Stocks for the Long Run (2014), With Updates to 2019.

But let's examine the typical investor.

Three Objectives Investors Care About

Almost all investors are concerned with three primary investment objectives (with differing levels of importance):

1. Generating sufficient income to maintain or improve their current lifestyle;
2. Not outliving their money and/or having enough money at their death to fulfill their legacy objectives (be it inheritance, philanthropy or some combination); and
3. Minimizing taxes paid along the way.

In a post-60/40 investment landscape, how should we be rethinking long-term portfolio construction to meet these investor objectives?

Working in collaboration with Professor Siegel, WisdomTree developed two "Siegel-WisdomTree" model portfolios.

These are constructed to address all the above-mentioned industry trends and the three identified primary investor objectives. Both portfolios are:

1. Heavily allocated to equities ("stocks for the long run"), to mitigate the longevity shortfall risk.
2. Within equities, allocated to more dividend/income/yield-oriented equities. This accomplishes two goals:
   a. Currently equities can potentially deliver higher yields than most bonds, so a yield-focused equity portfolio has better potential to deliver the income required to meet current lifestyle maintenance needs.
   b. The characteristics of the equities selected tend to be more defensive or lower-beta in nature. Despite the higher allocation to equities versus the traditional 60/40 portfolio, the Siegel-WisdomTree models have only modestly higher short-term volatility risk, and we believe the overall model portfolios have the potential to deliver improved *risk-adjusted* returns.
3. The all-ETF portfolio structure helps to optimize the tax-efficiency of the portfolio.[2]

Relative to traditional 60/40 portfolios, we believe the Siegel-WisdomTree models have the potential to provide:

1. Competitive risk-adjusted returns.
2. Higher current income/yield for lifestyle maintenance.
3. Increased long-term probability of not outliving your money and/or being able to fund your legacy objectives.
4. Slightly higher short-term volatility (standard deviation) risk.

We never subscribe to the phrase, "It's different this time." But we do believe in paying attention and responding to both investor objectives and current market conditions.

In the Siegel-WisdomTree models, we believe we've done both, while also enabling financial advisors to "outsource for growth."

Advisors increasingly leverage third-party model portfolios as they seek to increase scale and efficiency in their practice. This allows them to focus on their core competencies while they still deliver institutional-quality investment solutions.[3]

This new collaboration with Professor Siegel on model portfolios is the latest advisor solution WisdomTree is excited to bring to the market.

[1]See, for example, The Longevity Economy: Unlocking the World's Fastest-Growing, Most Misunderstood Market, by Joseph F. Coughlin, PublicAffairs Publishing, November 2017.

[2]ETFs generally can be more tax efficient than actively managed mutual funds, for a variety of structural reasons, including but not limited to (a) fewer taxable events during portfolio rebalancing and reallocation; (b) no annual payment of accrued but unrealized capital gains; and (c) more tax-favorable redemption and settlement procedures. This may not be true for all ETFs at all times, but the ETF structure generally is viewed to be more tax efficient than the mutual fund structure.

[3]See, for example, "https://www.deltadata.com/model-portfolios-are-the-future-of-investment-management/"

Important Risks Related to this Article

Please note, WisdomTree is not in business with Delta Data and we have not received any compensation for including a link to their article in this piece.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Funds before investing. To obtain a prospectus for WisdomTree Funds containing this and other important information, please call 866.909.9473 or visit WisdomTree.com to view or download a prospectus. Investors should read the prospectus carefully before investing.

There are risks associated with investing, including the possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country or sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, real estate, currency, fixed income and alternative investments include additional risks. Dividends are not guaranteed, and a company currently paying dividends may cease paying dividends at any time. Diversification does not eliminate the risk of experiencing investment losses. Due to the investment strategy of certain Funds, they may make higher capital gain distributions than other ETFs. Please see each Fund's prospectus for a discussion of risks.
WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

This content is for information only and is not intended to provide, and should not be relied on for, tax, legal, accounting, investment or financial planning advice by WisdomTree, nor should it be considered or relied upon as a recommendation by WisdomTree regarding the use or suitability of any model portfolio or any particular security.

This content has been prepared without regard to the individual financial circumstances and objectives of any investor, and the appropriateness of a particular investment or

strategy will depend on an investor's individual circumstances and objectives. Investors and their advisors should consider the investor's individual financial circumstances, investment time frame, risk tolerance level and investment goals. Investors should consult with their own advisors before engaging in any transaction. Using an asset allocation strategy does not ensure a profit or protect against loss, and diversification does not eliminate the risk of experiencing investment losses. There is no assurance that investing in accordance with a model portfolio's allocations will provide positive performance over any period. The model portfolios are provided "as is," without any warranty of any kind, express or implied. Information and other marketing materials provided to you by WisdomTree or any third party concerning a WisdomTree model portfolio, including allocations, performance and other characteristics, may not be indicative of an investor's actual experience from an account managed in accordance with a model portfolio's strategy.

Neither WisdomTree Investments, Inc., nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax advice. All references to tax matters or information provided on this site are for illustrative purposes only and should not be considered tax advice and cannot be used for the purpose of avoiding tax penalties. Investors seeking tax advice should consult an independent tax advisor.

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.

For more investing insights, check out our Economic & Market Outlook

View the online version of this article here.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

60/40 Portfolio : A portfolio of 60% equities and 40% fixed income.

Risk : Also standard deviation, which measures the spread of actual returns around an average return during a specific period. Higher risk indicates greater potential for returns to be farther away from this average.

Standard deviation : measure of how widely an investment or investment strategy's returns move relative to its average returns for an observed period. A higher value implies more "risk", in that there is more of a chance the actual return observed is farther away from the average return.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

Dividend : A portion of corporate profits paid out to shareholders.

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.

Beta : A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

Risk-adjusted returns : Returns measured in relation to their own variability. High returns with a high level of risk indicate a lower probability that actual returns were close to average returns. High returns with a low level of risk would be more desirable, as they indicate a higher probability that actual returns were close to average returns.