
INVESTING IN A POST-60/40 MARKET REGIME

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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 Lab¹ 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.

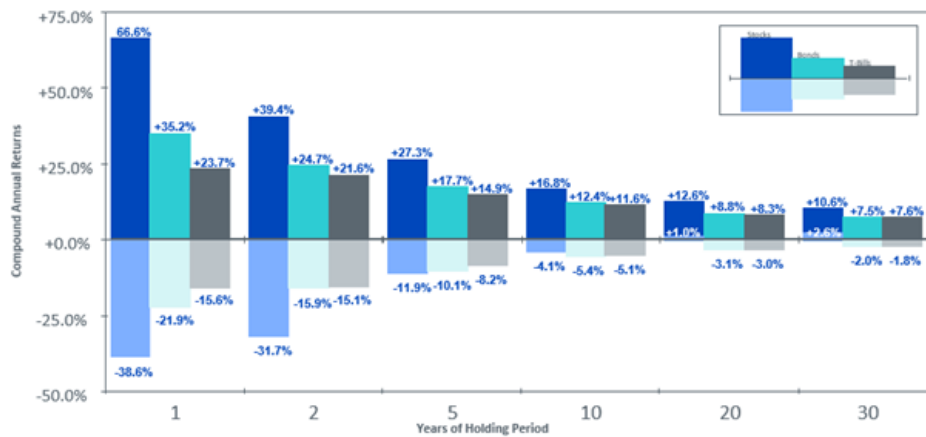
This requires us to redefine [risk](#) in long-term investment portfolios.

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



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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.

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

²ETFs 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.

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

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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.