MID-YEAR ASSET ALLOCATION OUTLOOK: IT'S ALL RIGHT, I THINK WE'RE GONNA MAKE IT

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I know, I know what's on your mind
And I know it gets tough sometimes
But you can give it one more try, to find another reason why
You should pick it up, and try it again

Cause it's all right—I think we're gonna make it,
I think it might just work out this time
It's all right—I think we're gonna make it
I think it might work out fine this time…

Time and time again I see people so unsure like me
We all know it gets hard sometimes
(But) You can give it one more try, find another reason why
You should pick it up,
(Yeah) You should kick it up, and try it again

Cause it's all right—I think we're gonna make it
I think it might just work out this time
(Yes) It's all right—I think we're gonna make it
I think it might work out fine this time…

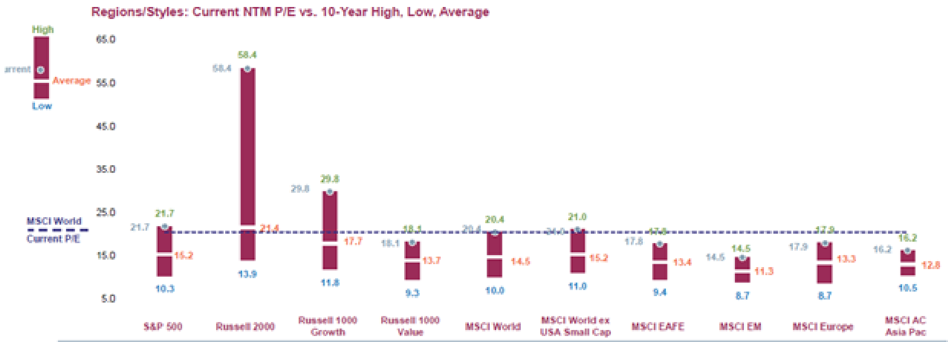
(From "All Right," by Christopher Cross, 1983)

Despite the disruptions caused by the pandemic in the first half of the year, our outlook from an asset allocation perspective has not changed from what it was at the start of the year.

It follows four main themes:

1. **Stocks over Bonds**: The fact is that nothing looks attractively valued right now, across the capital spectrum. But we still believe that equities offer better performance potential over the remainder of this year and into 2021.

The market bounce back in the second quarter brought equity valuations back to the dizzying levels we saw before the pandemic hit.



	S&P 500	Russell 2000	Russell 1000 Growth	Russell 1000 Value	MSCI World	MSCI World ex USA Small Cap	MSCI EAFE	MSCI EM	MSCI Europe	MSCI AC Asia Pac
High Date	6/20	6/20	6/20	6/20	6/20	6/20	6/20	6/20	6/20	6/20
Low Date	9/11	9/11	9/11	9/11	9/11	9/11	9/11	9/11	9/11	9/11

Source: Eaton Vance Monthly Market Monitor, 7/20.

For definitions of terms in the chart, please visit our glossary.

Markets have already discounted the horrible first half and are expecting horrible earnings news from Q2. But they are also pricing in (a) an anticipation of earnings improvement as we finish 2020 and head into 2021, and (b) the continuation of *massive* monetary and fiscal stimulus.

As we go to publication, the consensus is that we will see at least another $1 trillion in fiscal stimulus over the summer. There will be deep differences between the two parties as to how to allocate and implement that additional stimulus. But we believe there is enough common ground for a bargain to be struck.

Given the strong tailwinds of ongoing monetary and fiscal stimulus and a slowly recovering global economy, combined with our muted outlook for rates and credit, we still favor equities over bonds for both total return and current income potential.

2. Shorten Duration, Over-Weight Credit and Be Selective: On the rates and credit front, we believe that interest rates will grind slowly higher as the economy recovers. But that is on a comparative basis, as they are at or near all-time lows. From an absolute rate level, our outlook remains "lower for longer."

In the current yield and duration environment, even small increases in yield can trigger price losses exceeding projected annual coupon payments. These current valuations position Treasuries as a hedge against extreme events but not as a resilient investment for an entire cycle.

	Aggregate	MBS	ABS	CMBS	Corporate	Preferred	Floating-Rate Loans	Emerging Markets (USD)	High Yield
Max Spread Date	12/3/2008	12/3/2008	1/6/2009	11/21/2008	12/3/2008	3/9/2009	12/19/2008	10/24/2008	12/15/2008
Min Spread Date	1/31/2018	7/27/2010	10/1/2009	1/31/2018	2/22/2007	12/6/2017	3/31/2006	6/1/2007	6/1/2007
Spread on 12/31/19	39	39	44	72	93	17	461	291	360
Spread on 12/31/18	54	35	53	86	153	242	551	415	533
Spread on 12/31/17	36	25	36	62	93	-30	405	285	358

Source: Factset as of 6/30/20. Spread history measures past 15 years. Data provided is for informational use only. See end of report for important additional information. All fixed-income spreads are in basis points and measure option-adjusted yield spread relative to comparable maturity U.S. Treasuries using daily data. Loan Index spread represents the three-year discounted spread over LIBOR. Aggregate represented by Bloomberg Barclays US Aggregate Index. MBS represented by Bloomberg Barclays U.S. Mortgage Backed Securities (MBS) Index. ABS represented by Bloomberg Barclays U.S. Asset Backed Securities (ABS) Index. CMBS represented by Bloomberg Barclays U.S. CMBS Investment Grade Index. Corporate represented by Bloomberg Barclays U.S. Corporate Investment Grade Index. Preferred represented by ICE BofA Fixed Rate Preferred Securities Index. Floating-Rate Loans represented by S&P/LSTA Leveraged Loan Index. Emerging Markets(USD) represented by J.P. Morgan Emerging Markets Bond Index (EMBI) Global Diversified. High Yield represented by ICE BofA US High Yield Index.

Source: Eaton Vance Monthly Market Monitor, 7/20.

Given our general outlook for economic recovery and unprecedented Federal Reserve support, we prefer spread risk in corporate and mortgage-backed securities over interest rate risk and are thus under-weight duration in our portfolios. We are over-weight corporate debt and securitized debt at the expense of Treasuries. We are also positioned for further steepening in the Treasury curve, given our belief that rate increases will be concentrated in longer maturities.

In more aggressive portfolios, we would suggest small allocations to either emerging market local debt or corporate debt. Each exposure would enhance and diversify income levels. Several EM countries still have room to cut monetary policy rates, potentially generating additional bond gains for local debt.

3. U.S. over non-U.S.: From a global asset allocation perspective, and compared to the MSCI ACWI, we recommend staying (1) over-weight to the U.S., (2) slightly under-weight to developed international and (3) slightly over-weight to emerging markets.

There has been talk recently about the potential for some degree of the "mutualization" of eurozone debt, making it easier for the less economically strong southern countries (especially Italy) to access the capital markets. This has the potential to be a game changer for the eurozone, as it struggles to recover from a virus-induced recession. It may ultimately influence our outlook for Europe and the overall developed international markets.

But we continue to believe that the structural deficiencies of the European economy (high taxes and entitlements, low labor mobility, high unemployment among the young, rapidly changing demographics, an oppressive regulatory regime, etc.) will be a drag on economic and earnings growth potential for the foreseeable future.

While the pandemic has not played itself out in the emerging markets (especially Russia, Mexico and India), we believe a slowly recovering global economy (especially China) bodes well for the EM sector. At the same time, the U.S. dollar has fallen fairly steadily since late March—a trend that we believe will continue, albeit in fits and starts. If we are correct, this will provide an additional tailwind for EM and other non-U.S. risk assets.

4. Maintain Risk Factor Diversification: In addition to the more traditional asset class diversification, we are big believers in risk factor diversification.

Many investors are familiar with the traditional asset class "performance quilt" highlighting the benefits of a diversified portfolio:

																2005 - 2019	
2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	YTD	Ann.	Vol.
EM Equity 34.5%	REITs 35.1%	EM Equity 39.8%	Fixed Income 5.2%	EM Equity 79.0%	REITs 27.9%	REITs 8.3%	REITs 19.7%	Small Cap 38.8%	REITs 28.0%	REITs 2.8%	Small Cap 21.3%	EM Equity 37.8%	Cash 1.8%	Large Cap 31.5%	Fixed Income 6.1%	Large Cap 9.0%	REITs 22.2%
Comdty. 21.4%	EM Equity 32.6%	Comdty. 16.2%	Cash 1.8%	High Yield 59.4%	Small Cap 26.9%	Fixed Income 7.8%	High Yield 19.6%	Large Cap 32.4%	Large Cap 13.7%	Large Cap 1.4%	High Yield 14.3%	DM Equity 25.6%	Fixed Income 0.0%	REITs 28.7%	Cash 0.5%	REITs 8.3%	EM Equity 22.1%
DM Equity 14.0%	DM Equity 26.9%	DM Equity 11.6%	Asset Alloc. -25.4%	DM Equity 32.5%	EM Equity 19.2%	High Yield 3.1%	EM Equity 18.6%	DM Equity 23.3%	Fixed Income 6.0%	Fixed Income 0.5%	Large Cap 12.0%	Large Cap 21.8%	REITs -4.0%	Small Cap 25.5%	Large Cap -3.1%	Small Cap 7.9%	Comdty. 18.6%
REITs 12.2%	Small Cap 18.4%	Asset Alloc. 7.1%	High Yield -26.9%	REITs 28.0%	Comdty. 16.8%	Large Cap 2.1%	DM Equity 17.9%	Asset Alloc. 14.9%	Asset Alloc. 5.2%	Cash 0.0%	Comdty. 11.8%	Small Cap 14.6%	High Yield -4.1%	DM Equity 22.7%	Asset Alloc. -4.5%	EM Equity 7.8%	Small Cap 17.7%
Asset Alloc. 8.1%	Large Cap 15.8%	Fixed Income 7.0%	Small Cap -33.8%	Small Cap 27.2%	Large Cap 15.1%	Cash 0.1%	Small Cap 16.3%	High Yield 7.3%	Small Cap 4.9%	DM Equity -0.4%	EM Equity 11.6%	Asset Alloc. 14.6%	Large Cap -4.4%	Asset Alloc. 19.5%	High Yield -4.7%	High Yield 7.2%	DM Equity 17.3%
Large Cap 4.9%	Asset Alloc. 15.3%	Large Cap 5.5%	Comdty. -35.6%	Large Cap 26.5%	High Yield 14.8%	Asset Alloc. -0.7%	Large Cap 16.0%	REITs 2.9%	Cash 0.0%	Asset Alloc. -2.0%	REITs 8.6%	High Yield 10.4%	Asset Alloc. -5.8%	EM Equity 18.9%	EM Equity -9.7%	Asset Alloc. 6.6%	Large Cap 14.0%
Small Cap 4.6%	High Yield 13.7%	Cash 4.8%	Large Cap -37.0%	Asset Alloc. 25.0%	Asset Alloc. 13.3%	Small Cap -4.2%	Asset Alloc. 12.2%	Cash 0.0%	High Yield 0.0%	High Yield -2.7%	Asset Alloc. 8.3%	REITs 8.7%	Small Cap -11.0%	High Yield 12.6%	DM Equity -11.1%	DM Equity 5.3%	High Yield 10.9%
High Yield 3.6%	Cash 4.8%	High Yield 3.2%	REITs -37.7%	Comdty. 18.9%	DM Equity 8.2%	DM Equity -11.7%	Fixed Income 4.2%	Fixed Income -2.0%	EM Equity -1.8%	Small Cap -4.4%	Fixed Income 2.6%	Fixed Income 3.5%	Comdty. -11.2%	Fixed Income 8.7%	Small Cap -13.0%	Fixed Income 4.1%	Asset Alloc. 10.0%
Cash 3.0%	Fixed Income 4.3%	Small Cap -1.6%	DM Equity -43.1%	Fixed Income 5.9%	Fixed Income 6.5%	Comdty. -13.3%	Cash 0.1%	EM Equity -2.3%	DM Equity -4.5%	EM Equity -14.6%	DM Equity 1.5%	Comdty. 1.7%	DM Equity -13.4%	Comdty. 7.7%	REITs -13.3%	Cash 1.3%	Fixed Income 3.4%
Fixed Income 2.4%	Comdty. 2.1%	REITs -15.7%	EM Equity -53.2%	Cash 0.1%	Cash 0.1%	EM Equity -18.2%	Comdty. -1.1%	Comdty. -9.5%	Comdty. -17.0%	Comdty. -24.7%	Cash 0.3%	Cash 0.8%	EM Equity -14.2%	Cash 2.2%	Comdty. -19.4%	Comdty. -2.6%	Cash 1.0%

Source: J.P. Morgan Asset Management, "Guide to the Markets," Q3 2020 and Barclays, Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management. Data as of 6/30/20.
Large cap: S&P 500; small cap: Russell 2000; EM equity: MSCI EME; DM equity: MSCI EAFE; commodity: Bloomberg Commodity Index; high yield: Bloomberg Barclays Global High Yield Index; fixed income: Bloomberg Barclays U.S. Aggregate; REITs: NAREIT Equity REIT Index; cash: Bloomberg Barclays 1-3m Treasury. The "asset allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EME, 25% in the Bloomberg Barclays U.S. Aggregate, 5% in the Bloomberg Barclays 1-3m Treasury, 5% in the Bloomberg Barclays Global High Yield Index, 5% in the Bloomberg Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. Annualized (Ann.) return and volatility (Vol.) represent 12/31/04–12/31/19 period. All data represents total return for stated period. The asset allocation portfolio is for illustrative purposes only. Past performance is not indicative of future returns.

A concept that some investors may be less familiar with is that risk factors, just like asset classes, also rotate in and out of favor:

Currently Displaying: Universe: WTUSMFU - Quartile: 1st Quartile - Weighting: Factor - As of: 2020-06-30

2002	2003	2004	2005	2006	2007	2008	2009	2010
Momentum (-1.4%)	Value (46.32%)	Correlation (24.04%)	Quality (15.8%)	LowVol (19.36%)	Quality (10.93%)	LowVol (-23.16%)	Value (58.13%)	Quality (25.47%)
LowVol (-2.56%)	WTUSMFU (38.38%)	Multifactor (21.43%)	Value (15.24%)	Momentum (17.42%)	Correlation (7.33%)	Momentum (-25.75%)	WTUSMFU (40.14%)	WTUSMFU (23.23%)
Multifactor (-2.87%)	Correlation (34.08%)	Value (19.65%)	Correlation (15.0%)	Value (17.36%)	Size (7.16%)	Multifactor (-32.93%)	Quality (38.07%)	Value (20.57%)
Correlation (-7.41%)	Quality (32.93%)	LowVol (18.53%)	Multifactor (14.05%)	Multifactor (15.42%)	Multifactor (5.85%)	Quality (-35.08%)	Correlation (32.81%)	Correlation (20.12%)
Quality (-8.27%)	Multifactor (30.97%)	Quality (17.46%)	WTUSMFU (11.18%)	WTUSMFU (14.6%)	WTUSMFU (5.77%)	Size (-36.67%)	Size (32.79%)	Momentum (17.56%)
Value (-15.47%)	Size (30.15%)	WTUSMFU (17.44%)	Size (7.59%)	Size (13.39%)	Momentum (5.59%)	Value (-38.47%)	Multifactor (24.59%)	Multifactor (17.38%)
WTUSMFU (-17.97%)	LowVol (27.01%)	Momentum (17.01%)	Momentum (5.59%)	Quality (12.57%)	LowVol (1.14%)	WTUSMFU (-38.85%)	LowVol (20.2%)	LowVol (15.94%)
Size (-22.11%)	Momentum (25.57%)	Size (13.16%)	LowVol (5.07%)	Correlation (11.24%)	Value (0.27%)	Correlation (-41.0%)	Momentum (15.13%)	Size (14.5%)

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020 YTD
LowVol (12.31%)	Quality (18.82%)	Value (44.52%)	LowVol (17.2%)	Momentum (7.46%)	Value (19.44%)	Quality (25.42%)	LowVol (-1.27%)	Size (28.03%)	Correlation (-2.31%)
Momentum (12.06%)	Value (17.73%)	Size (35.77%)	Multifactor (16.54%)	LowVol (9.32%)	WTUSMFU (13.9%)	Size (22.21%)	Momentum (-2.14%)	Quality (27.97%)	Size (-6.44%)
Multifactor (10.85%)	WTUSMFU (17.2%)	WTUSMFU (35.31%)	Correlation (15.55%)	Quality (1.5%)	Quality (13.23%)	WTUSMFU (19.63%)	Correlation (-3.67%)	Value (27.75%)	Quality (-8.18%)
Correlation (4.41%)	Size (16.7%)	Correlation (34.81%)	Momentum (15.32%)	Size (0.66%)	LowVol (13.06%)	Value (19.1%)	Multifactor (-4.01%)	LowVol (27.45%)	Momentum (-9.53%)
Quality (3.4%)	Multifactor (15.67%)	Quality (33.78%)	Size (14.29%)	Multifactor (0.55%)	Size (11.59%)	Momentum (18.77%)	Size (-4.36%)	WTUSMFU (27.1%)	WTUSMFU (-10.46%)
Size (1.05%)	Correlation (15.52%)	Multifactor (32.23%)	Value (13.58%)	WTUSMFU (-1.31%)	Momentum (9.95%)	Multifactor (17.32%)	Quality (-6.65%)	Momentum (26.01%)	Multifactor (-11.16%)
WTUSMFU (0.13%)	Momentum (13.15%)	Momentum (27.99%)	Quality (13.52%)	Value (-5.9%)	Multifactor (7.97%)	LowVol (17.24%)	WTUSMFU (-7.85%)	Correlation (23.15%)	LowVol (-13.36%)
Value (-1.34%)	LowVol (12.9%)	LowVol (23.72%)	WTUSMFU (12.72%)	Correlation (-7.79%)	Correlation (7.59%)	Correlation (13.51%)	Value (-13.2%)	Multifactor (30.11%)	Value (-22.17%)

Source: WisdomTree Asset Management, 7/20.

A core investment tenet at WisdomTree is that by maintaining both asset class and risk factor diversification, advisors and investors have the potential to achieve a more consistent performance profile over time—something that may be increasingly important as we head into what we believe will be a much more volatile market environment.

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

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DEFINITIONS

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Monetary stimulus : refers to attempts to use monetary policy like lowering interest rates or quantitative easing to stimulate the economy.

Fiscal Stimulus : Using fiscal policy as a tool to provide economic growth.

Duration : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

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

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.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Mortgage-backed securities : Fixed income securities that are composed of multiple underlying mortgages.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

MSCI ACWI ex-U.S. Index : A free-float adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets excluding companies based in the United States.