

Is the Traditional 60/40 Dead? Redefining Diversification with Efficient Core Solutions

Published February 26, 2025

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Key Takeaways

- With private market assets projected to surpass \$60 trillion by 2032, investors are increasingly seeking diversification beyond traditional 60/40 portfolios.
- WisdomTree's Efficient Core strategies offer a capital-efficient approach, allowing investors to maintain core equity and bond exposures while integrating diversifiers like gold and commodities.
- By stacking assets within a single solution, these strategies create room for alternative investments without sacrificing long-term return potential, positioning portfolios for enhanced resilience and growth.

Private market assets are projected to grow at more than twice the rate of public assets, reaching \$60 trillion to \$65 trillion by 2032.¹ This anticipated expansion underscores investors' search for portfolio diversification, across all diversifiers like private equity, private credit, broad commodities, real estate, infrastructure and gold. Academic research consistently demonstrates that such diversification enhances a portfolio's risk/return profile. And such diversification is particularly pertinent now given the rising concentration in market cap-weighted indexes, where a handful of large tech companies dominate, thereby reducing diversification within these core portfolio components. However, achieving this additional diversification presents a significant challenge: how to incorporate these assets while maintaining exposure to core holdings like public equities and fixed income.

The Diversification Dilemma: Finding the space for More and More Diversifiers

In recent years, WisdomTree has conducted extensive research on enhancing portfolios through alternative assets and diversifiers to improve overall long-term efficiency. Our analyses, both retrospective and prospective, indicate that:

- Broad commodities could warrant an allocation of up to 15% in a multi-asset allocation (Shah & Debru, "The Case for Investing in Broad Commodities"), (Shah & Berlanda, "The Role of Broad Commodities in a Portfolio," September 2023).

- Most portfolios would benefit from a gold allocation of up to 10% or 15% (Shah & Berlanda, "The Role of Gold in a Portfolio," October 2023).

Collectively, these assets could constitute 20% of a portfolio. Employing a delta-one approach would necessitate a substantial reduction in allocations to bonds and, predominantly, equities to accommodate these diversifiers. Clearly, investors require innovative tools to address this issue and unlock new opportunities for their portfolios.

Introducing Efficient Core: A New Era of Smart Investing

To tackle this challenge, WisdomTree has developed a range of Efficient Core strategies designed to enhance capital efficiency by stacking multiple assets within a single solution. This framework is very flexible, allowing us to provide a 90% exposure to large-cap equities and a 60% exposure to U.S. Treasury bonds for every \$100 invested. Or to stack 90% of gold futures contracts on top of a 90% allocation to large-cap equities.

The [WisdomTree U.S. Efficient Core Fund \(NTSX\)](#), [WisdomTree International Efficient Core Fund \(NTSI\)](#) and [WisdomTree Emerging Markets Efficient Core Fund \(NTSE\)](#) are comprised of three key exposures:

- **Equity Exposure:** 90% invested in a diversified basket of large-cap stocks in the relevant geography
- **Bond Exposure:** 60% in a diversified basket of U.S. Treasury bond future contracts, ranging from 2- to 30-year maturities
- **Cash Collateral:** 10% cash, serving as collateral for futures contracts

Effectively, this approach delivers a capital-efficient 60/40 allocation, freeing up capital that can be allocated to diversifying assets without sacrificing core equity and bond exposures.

The [WisdomTree Efficient Gold Plus Equity Strategy Fund \(GDE\)](#) also has three key exposures:

- **Equity Exposure:** 90% invested in a diversified basket of U.S. large-cap stocks
- **Gold Exposure:** 90% in gold futures contracts
- **Cash Collateral:** 10% cash, serving as collateral for futures contracts

Effectively, this approach allows the creation of a gold exposure in the portfolio without having to reduce the allocation to other risk assets such as gold.

Capital Efficiency in Portfolios: Making Room for Alts/Diversifiers

By using the [Efficient Core strategy](#), investors can maintain their desired exposure to traditional assets while freeing up capital to invest in diversifiers such as gold, private assets or broad commodities. This methodology facilitates the integration of alternative investments aimed at enhancing diversification and potential returns without compromising the foundational holdings of the portfolio. Additionally, it allows for the introduction of uncorrelated return streams, improved diversification, reduced portfolio volatility and more consistent performance across various market conditions.

Consider a practical example: starting with a 60/40 portfolio investing in global equities and U.S. Treasuries. Traditionally, incorporating commodities, gold or real estate would require reducing the equity allocation, as these diversifiers tend to exhibit volatility. However, by allocating 66.7% of the capital to Efficient Core Funds, an investor would achieve a 60% exposure to global equities, a 35% exposure to fixed income (via U.S. Treasury futures contracts) and 8% exposure to gold. This allocation leaves 28.3% of the capital available for investment in alternative assets and diversifiers of the investor's choice once 5% of U.S. Treasuries have been added to complete the 60/40.

Figure 1: Using the Efficient Core Strategy Creates Space for Both the 60/40 Exposure and Multiple Diversifiers

Asset Name	Capital Allocation	Asset Name	Investment Exposure
WisdomTree U.S. Efficient Core Fund	\$37.8	U.S. Equities	\$42.0
WisdomTree International Efficient Core Fund	\$13.3	International Equities	\$12.0
WisdomTree Emerging Markets Efficient Core Fund	\$6.7	EM Equities	\$6.0
WisdomTree Efficient Gold Plus Equity Strategy Fund	\$8.9	U.S. Treasuries	\$40.0
U.S. Treasury	\$5.3	Broad Commodities	\$10
Broad Commodities	\$10.0	Gold	\$8
Hedge Funds	\$5.0	Hedge Funds	\$5
Managed Futures	\$5.0	Managed Futures	\$5
Private Credit	\$8.0	Private Credit	\$8
Total	\$100	Total	\$136

For illustration only.

Conclusion

Diversification is increasingly becoming a key driver of portfolio construction. With correlations rising within and across asset classes, it is imperative for investors to explore beyond core assets and consider new asset classes that are becoming more accessible. Conversely, creating space in the portfolio for these diversifiers must not come at the expense of the portfolio's long-term return potential. The Efficient Core strategies provide a viable pathway to achieve this balance, enabling portfolios to be both diversified and positioned for long-term growth.

1 Source: Bain & Company. August 2024.

https://www.bain.com/about/media-center/press-releases/2024/private-market-assets-to-grow-at-more-than-twice-the-rate-of-public-assets-reaching-up-to-%2465-trillion-by-2032-bain--company-finds/?utm_source=chatgpt.com

Important Risks Related to this Article

Diversification does not eliminate the risk of experiencing investment losses.

There are risks associated with investing, including the possible loss of principal. Please read each Funds' prospectus for specific details regarding the Fund's risk profile.

NTSX: While the Fund is actively managed, the Fund's investment process is expected to be heavily dependent on quantitative models and the models may not perform as intended. Equity securities, such as common stocks, are subject to market, economic and business risks that may cause their prices to fluctuate. The Fund invests in derivatives to gain exposure to U.S. Treasuries. The return on a derivative instrument may not correlate with the return of its underlying reference asset. The Fund's use of derivatives will give rise to leverage and derivatives can be volatile and may be less liquid than other securities. As a result, the value of an investment in the Fund may change quickly and without warning and you may lose money. Interest rate risk is the risk that fixed income securities, and financial instruments related to fixed income securities, will decline in value because of an increase in interest rates and changes to other factors, such as perception of an issuer's creditworthiness.

NTSI: Investments in non-U.S. securities involve political, regulatory and economic risks that may not be present in U.S. securities. For example, foreign securities may be subject to risk of loss due to foreign currency fluctuations, political or economic instability, or geographic events that adversely impact issuers of foreign securities. While the Fund is actively managed, the Fund's investment process is expected to be heavily dependent on quantitative models and the models may not perform as intended. Equity securities, such as common stocks, are subject to market, economic and business risks that may cause their prices to fluctuate. The Fund invests in derivatives to gain exposure to U.S. Treasuries. The return on a derivative instrument may not correlate with the return of its underlying reference asset. The Fund's use of derivatives will give rise to leverage and derivatives can be volatile and may be less liquid than other securities. As a result, the value of an investment in the Fund may change quickly and without warning and you may lose money. Interest rate risk is the risk that fixed income securities, and financial instruments related to fixed income securities, will decline in value because of an increase in interest rates and changes to other factors, such as perception of an issuer's creditworthiness. Diversification does not eliminate the risk of experiencing investment losses.

NTSE: Investments in non-U.S. securities involve political, regulatory and economic risks that may not be present in U.S. securities. For example, foreign securities may be subject to risk of loss due to foreign currency fluctuations, political or economic instability, or geographic events that adversely impact issuers of foreign securities. Investments in securities and instruments traded in developing or emerging markets, or that provide exposure to such securities or markets, can involve additional risks relating to political, economic or regulatory conditions not associated with investments in U.S. securities and instruments or investments in more developed international markets. While the Fund is actively managed, the Fund's investment process is expected to be heavily dependent on quantitative models and the models may not perform as intended. Equity securities, such as common stocks, are subject to market, economic and business risks that may cause their prices to fluctuate. The Fund invests in derivatives to gain exposure

to U.S. Treasuries. The return on a derivative instrument may not correlate with the return of its underlying reference asset. The Fund's use of derivatives will give rise to leverage and derivatives can be volatile and may be less liquid than other securities. As a result, the value of an investment in the Fund may change quickly and without warning and you may lose money. Interest rate risk is the risk that fixed income securities, and financial instruments related to fixed income securities, will decline in value because of an increase in interest rates and changes to other factors, such as perception of an issuer's creditworthiness. Diversification does not eliminate the risk of experiencing investment losses.

GDE: The Fund is actively managed and invests in U.S.-listed gold futures and U.S. equity securities. The Fund's use of U.S.-listed gold futures contracts will give rise to leverage, magnifying gains and losses and causing the Fund to be more volatile than if it had not been leveraged. Moreover, the price movements in gold and gold futures contracts may fluctuate quickly and dramatically, and have a historically low correlation with the returns of the stock and bond markets. U.S. equity securities, such as common stocks, are subject to market, economic and business risks that may cause their prices to fluctuate. The Fund's investment strategy will also require it to redeem shares for cash or to otherwise include cash as part of its redemption proceeds, which may cause the Fund to recognize capital gains.