Stump the Guru

During my weekly podcast MoneyMattersUSA® with Fred Saide, the final segment is called Stump the Guru. Listeners can sign up on the website https://moneymattersusa.net dropdown named Stump the Guru or they can call in on our toll free number.800-593-8188. One of the listeners had a question that is on my mind right now for a couple of reasons. For one the bond market is signaling a recession while the equity market has not priced in a recession yet. My other consideration is the 60-40 portfolio viable at this time in a period of 'stagflation.'

The question posed by the listener is as follows: "I used to listen to you on the radio and just recently found your podcast. I manage most of my investments myself and have worked with a stockbroker for about seventeen (17) years for part of my investments. I really do not have a retirement income plan that you talk about. I just want to have enough to live happily ever after. My question is what's wrong with the 60-40 portfolio? I have had success with it in the past and some success with it now."

My reply is divided into five parts.

1. The 60-40 portfolio is challenging. The challenge is the 60-40 portfolio is unbalanced as it excludes factors which ae used to construct a portfolio. E.g., precious metals and other commodities. It may also exclude assets that hedge and are not overly risky such as short duration US Treasuries. They can also be in the form of ETF's and mutual funds with short duration treasury proxies.
2. Prior to the Federal Reserve tightening the 60-40 portfolio was running out of steam. Some people may stay with it and be satisfied with their risk adjusted returns. For those unsatisfied they will sell off. E.g., a six (6) percent return at zero (0) interest rates is ok, but the same return at five (5) percent inflation is not ok because the real yield is only one (1) percent. Studies show that people look at nominal yield rather than the more important real yield net of inflation to get their actual return.
3. Higher inflation means that both stocks and bonds become highly correlated with each other so there is lesser benefit in the 60-40 mix. Bonds do not provide the shock absorber effect they would offset equity risk. Since bond rates are opposite yields higher inflation causes bonds to decline in face value and inflation makes equities less desirable. It's unclear if the Fed really cares about asset prices in the stock market as this time so they may not intervene to help the markets the so called 'Fed put.' When the Federal Reserve tightens the markets sell off.
4. No one can predict the future. We don't know if we will repeat the past decade of low and stable inflation, strong earnings, and monetary and fiscal stimulus. Many investors need to accept the new reality that they will not get outstanding returns. The behavioral bias called 'recency bias' can lead people to think that what worked in the past will continue to work. During the lost decade from 2000 to 2010 the 60-40 portfolio returned only 2.3%. In 2022, the 60-40 portfolio generated a 2% return. Now some will say don't judge a strategy by a one-year return. However, it's' not just one year as I indicated.

5. The last observation is to avoid takin more equity risk than you are comfortable with or can afford if your investments turn sour in the hope you will get a better return for more risk taking. This is where an advisor can help because a smart savvy set of tactics are needed. And even a new strategy. I would also suggest these considerations:
    - Tax-efficient strategies need to be employed.
    - Using both active and passive investing
    - Investing in many asset classes, sectors and factors and using fixed index annuities as a bond substitution play because it shirts the efficient frontier and the insurance company is in effect a bond institution manager
    - Consider using hedging to diversify risk. Here are ETF's and mutual funds that can accomplish hedging if you don't want to try it yourself which may be expensive.

Consider our 2nd opinion program called Red Light on the Dashboard which can be found on our drop down menu or https://moneymattersusa.net/red-light

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