Can TAA replace the 60/40 portfolio?

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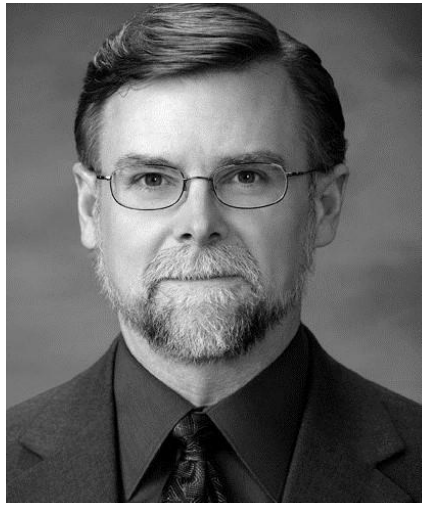

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TAA, does it solve for the fact that bonds can’t work with interest rates this low?

Do I replace my clients balanced stock/bond portfolio with TAA?

In part or in whole?

It is impossible for bonds to play their necessary role - Part 1

Bloomberg Business

Opinion & Advice

Sovereign Bonds May Not Save Your Portfolio

By Richard Cookson
October 28, 2020, 11:30 PM MST

- **Government debt cannot diversify your portfolio. It may end up amplifying your risks.**
- **Worst of all, pretty much every institutional investor uses a risk-management system that assumes a negative correlation between bonds and equities. If this flips around then they would have to cut all risk willy-nilly. All these things mean that a correlation turnaround, were it to occur, would be fast and savage.**

My working life has included pretty much the highest and lowest government bond yields in history. In the early 1980s U.S. 10-year yields touched 16%. Earlier this year they fell to 50 basis points. That's

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USA TODAY

Money

Is it time to forget what you learned about investing in bonds?

By Russ Wiles
October 27, 2020, 1:12 PM ET

- **Yields have dropped so much, that their income and diversification benefits are questioned**
- **Bonds - It's simply an asset class with no positive expected returns**

The stock market has had a wild ride this year, and more turbulence could lie ahead, what with a rancorous presidential election nearing and possibly more economic damage if a second COVID-19 wave hits.

But it might be the bond side of your portfolio where surprise risks lurk.

Bloomberg Business

Markets

The 40 in 60/40 Portfolios Is Getting Wilder and Wilder

By Sally Bakewell and Paula Seligson
October 24, 2020, 6:00 AM MST

- **Record-low yields make conventional formula untenable for many**
- **Some seeking more esoteric types of debt to meet obligations**

It probably sounds crazy to talk about a crisis facing American investors right now. The stock market is still white hot, and bonds have barely lost a beat after surging earlier this year.

Yet dig a little deeper and you'll notice not all is as it seems.

For one, sky-high debt prices have made it more difficult to hedge against losses should the relentless

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Bloomberg Business

Markets

In New 60/40 Portfolio, Riskier Hedges Are Displacing U.S. Debt

By Vivien Lou Chen and Katherine Greifeld
October 20, 2020, 3:00 AM MST

- **Surging demand seen in options to offset stocks at Swan Global**
- **Currencies are another alternative 'few are good at': Toews**

The hunt for new hedges is in full gear.

While much has been made about the search for yield in a world of ultra-low interest rates, valuations in the U.S. Treasury market also leave very little room for price gains to counteract losses should the high-flying stock market turn lower. It's a dilemma that could reshape the classic investing strategy of 60% stocks and 40% bonds as the Federal Reserve holds rates near zero for the foreseeable future.

It is impossible for bonds to play their necessary role - Part 5

Bloomberg Business

Markets

If 60/40 Keeps Working, Democracy Has Failed, Paul McCulley Says

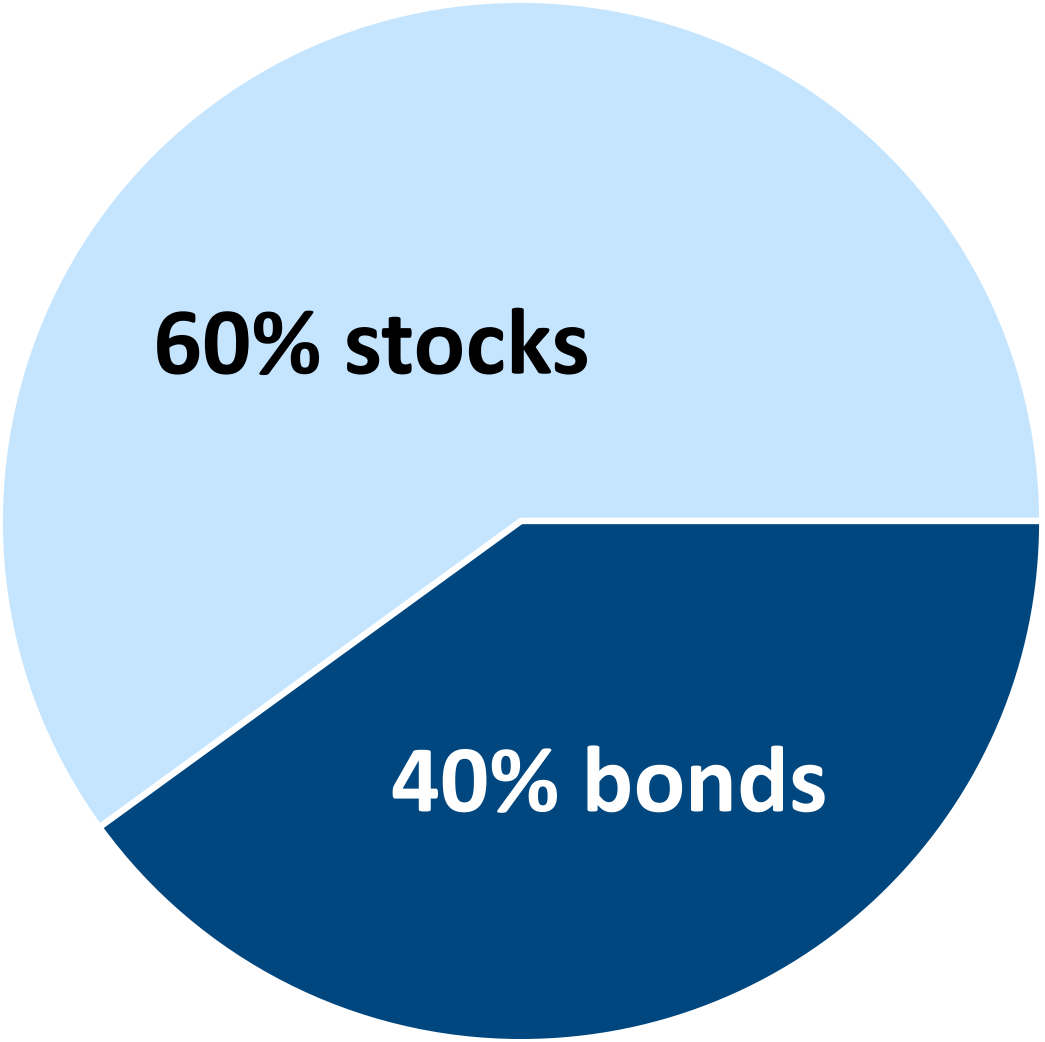
By Joe Weisenthal
September 3, 2020, 3:00 AM MST

- **Strategy's success signals capital's win over labor, he says**
- **Former Pimco economist hopes Wall Street finds 'new paradigm'**

Portfolios consisting of 60% equities and 40% bonds have had an incredible run, both this year and over the long term.

However, with yields on long-term Treasuries near all-time lows, the chorus of naysayers toward the so-called 60/40 portfolio has grown. The criticism is based on the very reasonable grounds that you're not getting paid much to hold bonds and there isn't much scope left for capital appreciation.

60/40 portfolio defined - sometimes called a "balanced portfolio"



Well diversified across the stocks of 500 prominent U.S. corporations

Well diversified across intermediate-term U.S. Treasury bonds and high-quality investment grade U.S. corporate bonds

60/40 portfolio has delivered consistent long-term success

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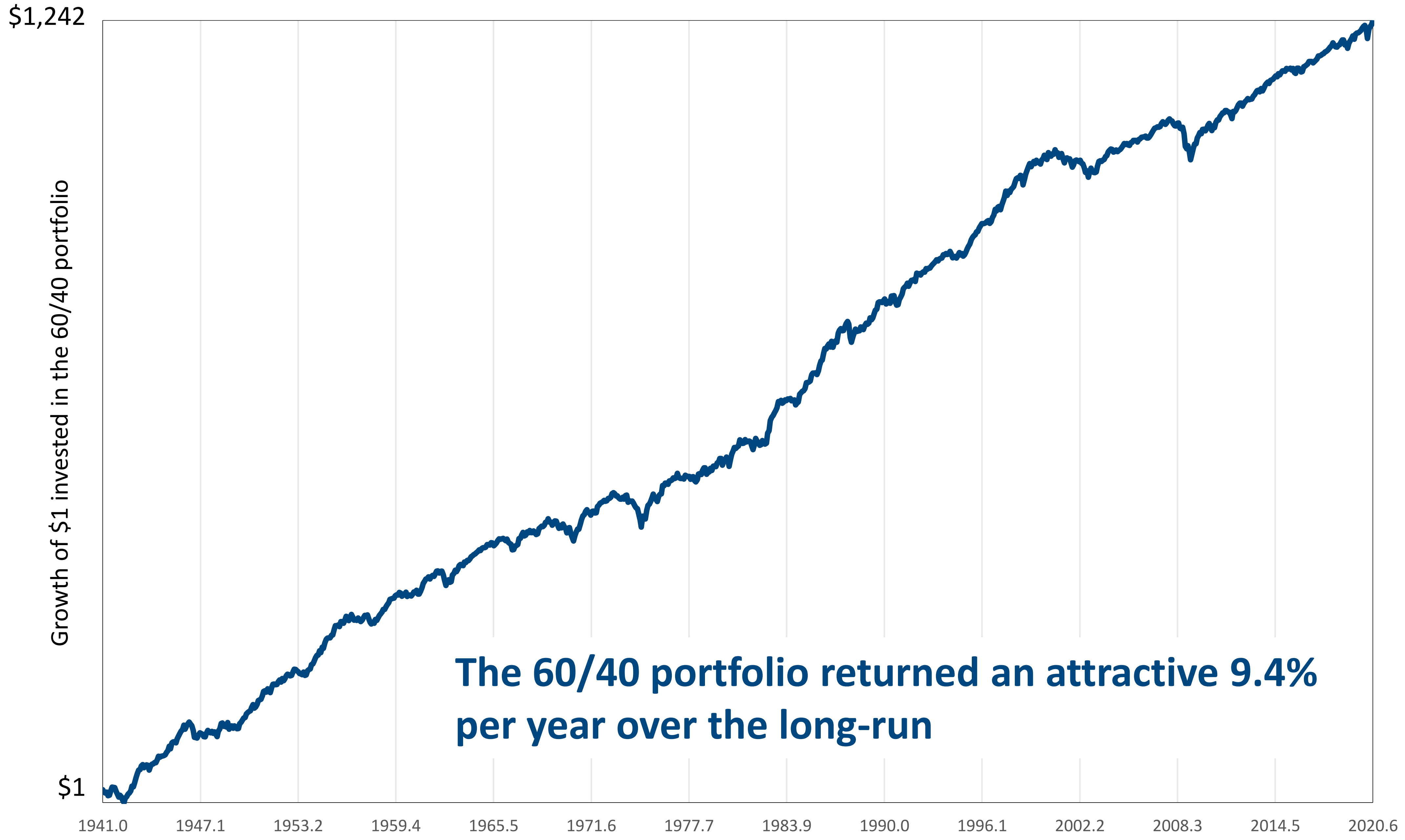
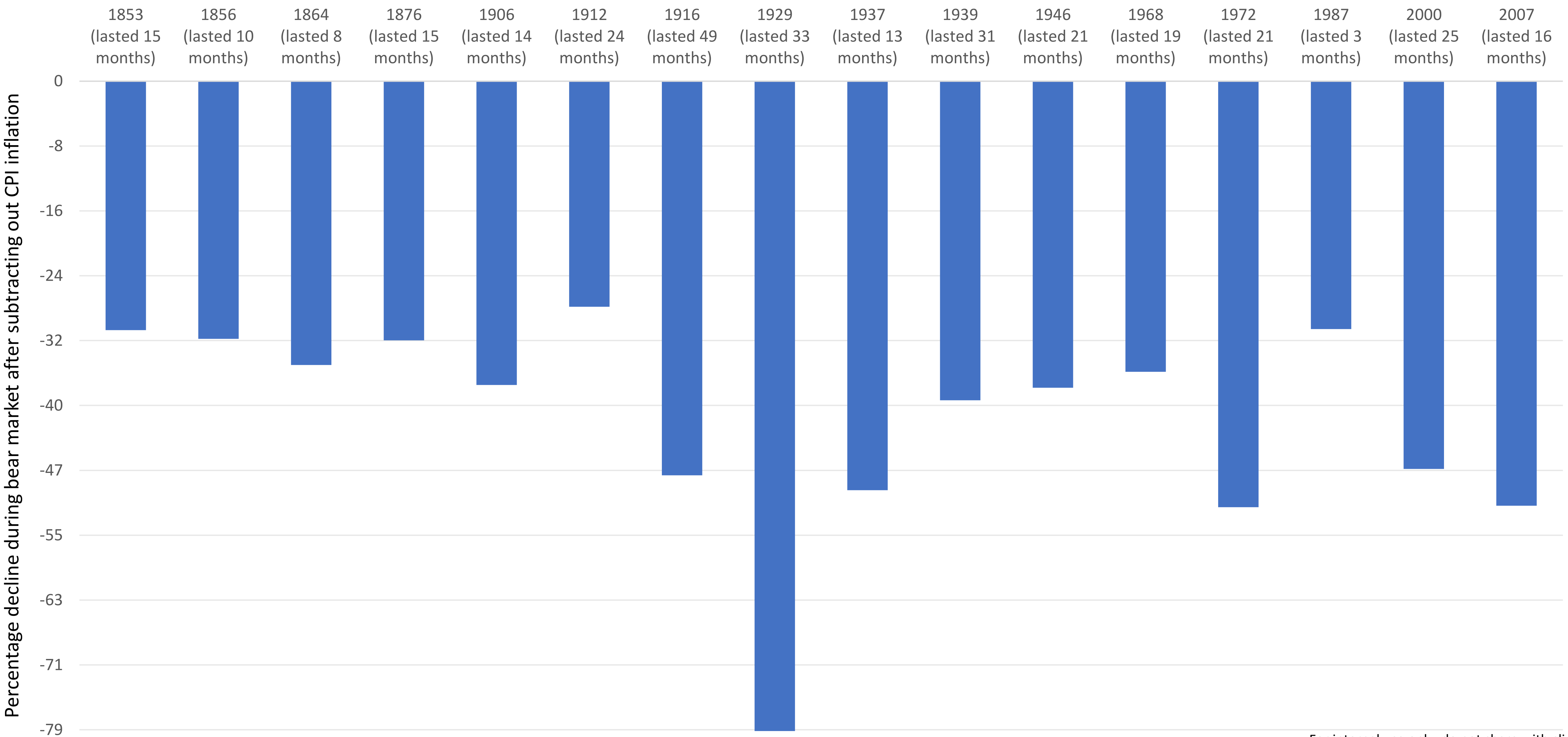


See Disclosure # 1 on the last page

The successful 60/40 portfolio requires genuine bear market mitigation

Bear markets have been both severe and long-lasting



Bonds play a vital role within the 60/40 portfolio

Partially offset stock losses during bear market

PRIMARY role of bonds in a larger portfolio

Current income

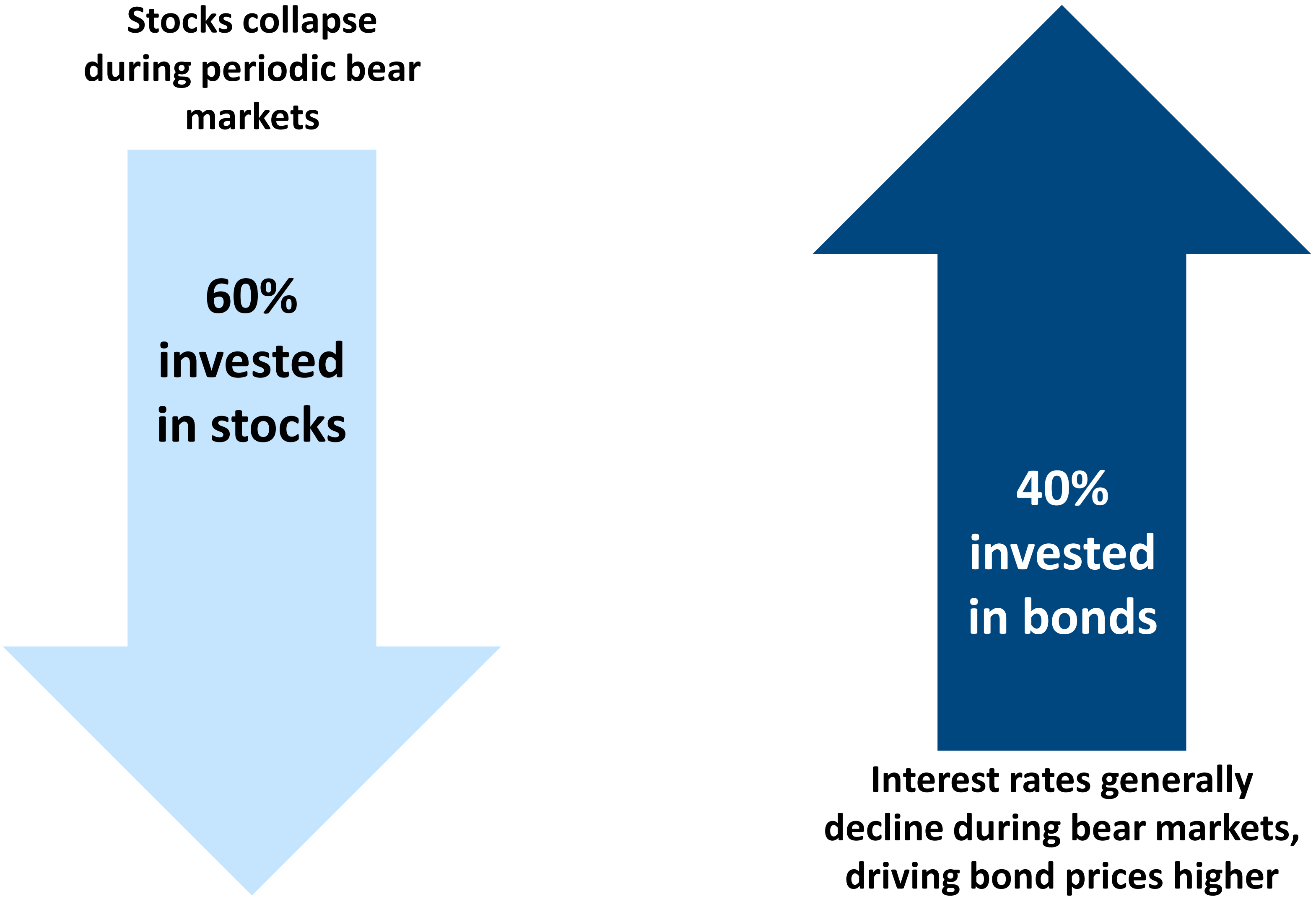
SECONDARY role of bonds in larger portfolio

Relationship between interest rates and bond prices

When interest rates rise

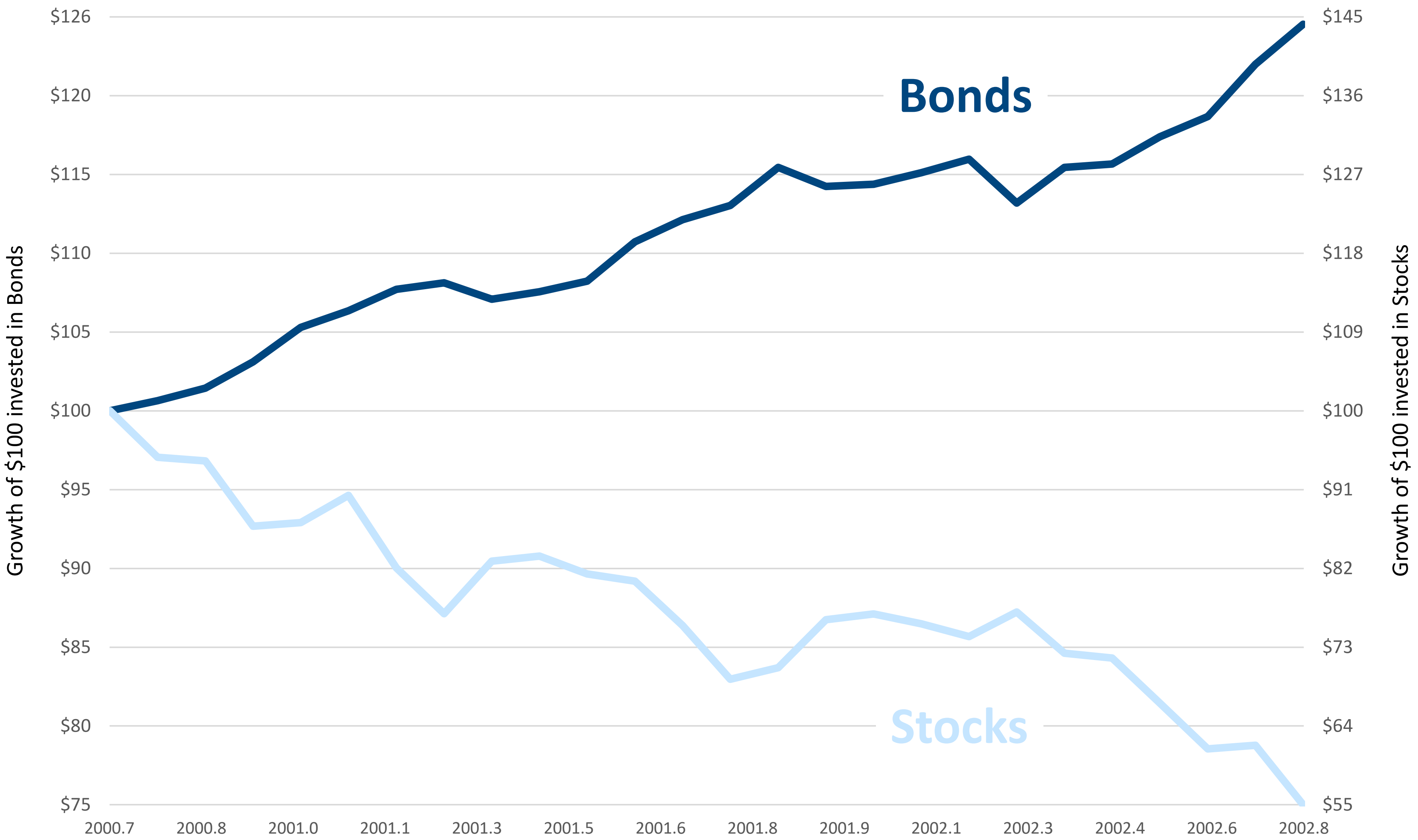
When interest rates fall

Why the 60/40 portfolio works so well

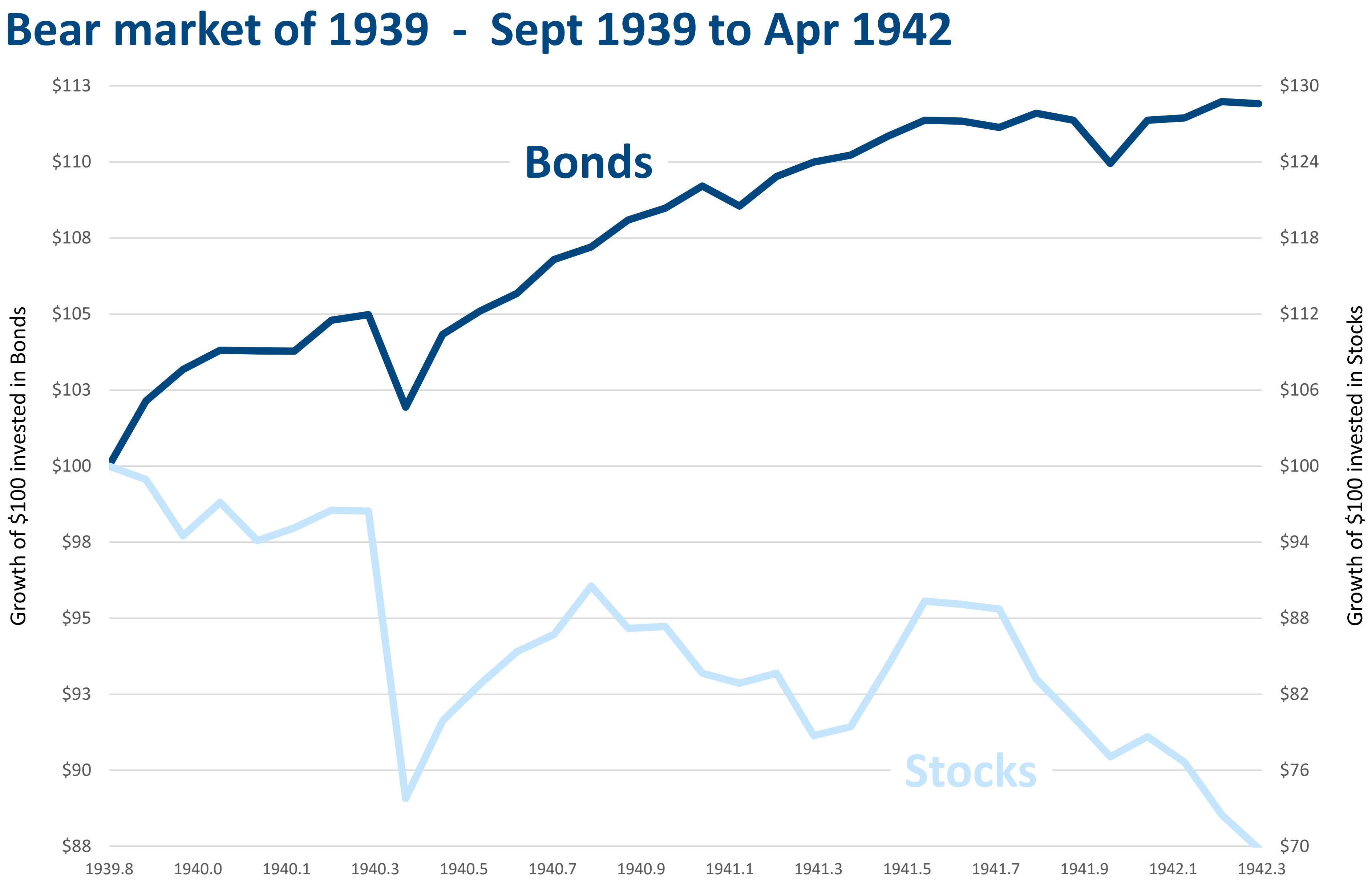


An example of past success - bonds play a vital role

Bear market of 2000 - Aug 2000 to Sept 2002



A second example of past success - bonds play a vital role



See Disclosure # 4 on the last page

But the world is different today - and not in a small way

If interest rates rise, bonds can't play their necessary role

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Bond prices will rise or fall by the following amounts depending on the direction interest rates take

Change in interest rates (from current levels)	10-year U.S. Treasury bond	30-year U.S. Treasury bond
-25bps	**+2%**	**+6%**
+25bps	**-2%**	**-6%**
+50bps	**-5%**	**-12%**
+100bps	**-10%**	**-25%**
+200bps	**-19%**	**-49%**
+250bps	**-24%**	**-61%**

Based on where interest rates stood on August 19, 2020
Assumes an instantaneous change in the level of interest rates, i.e., overnight

See Disclosure # 6 on the last page

The next bear market may be very uncomfortable

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BEST case scenario - Your 60/40 portfolio losses -20%

Stocks collapse during modest bear market

Stocks fall -35%

Earn +2 ½% on your bonds

Bonds deliver their current yield plus very slight price appreciation

The next bear market . . . could be even worse

WORST case scenario - Your 60/40 portfolio losses -35%

Stocks collapse during robust bear market

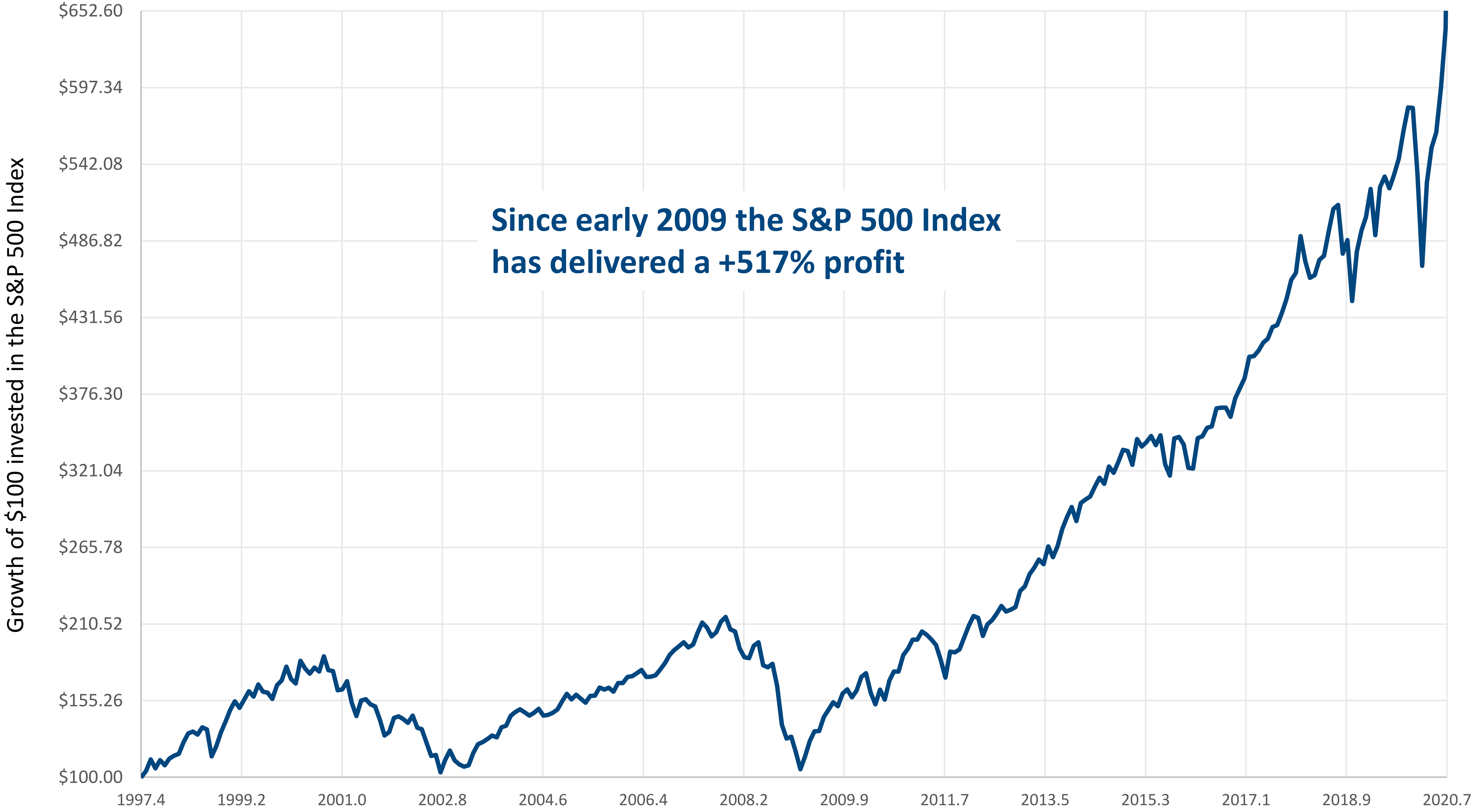
Stocks fall -45%

Bonds lose -20%

Bonds deliver their current yield but suffer significant decline as interest rates rise

The next bear market is closer than one might think

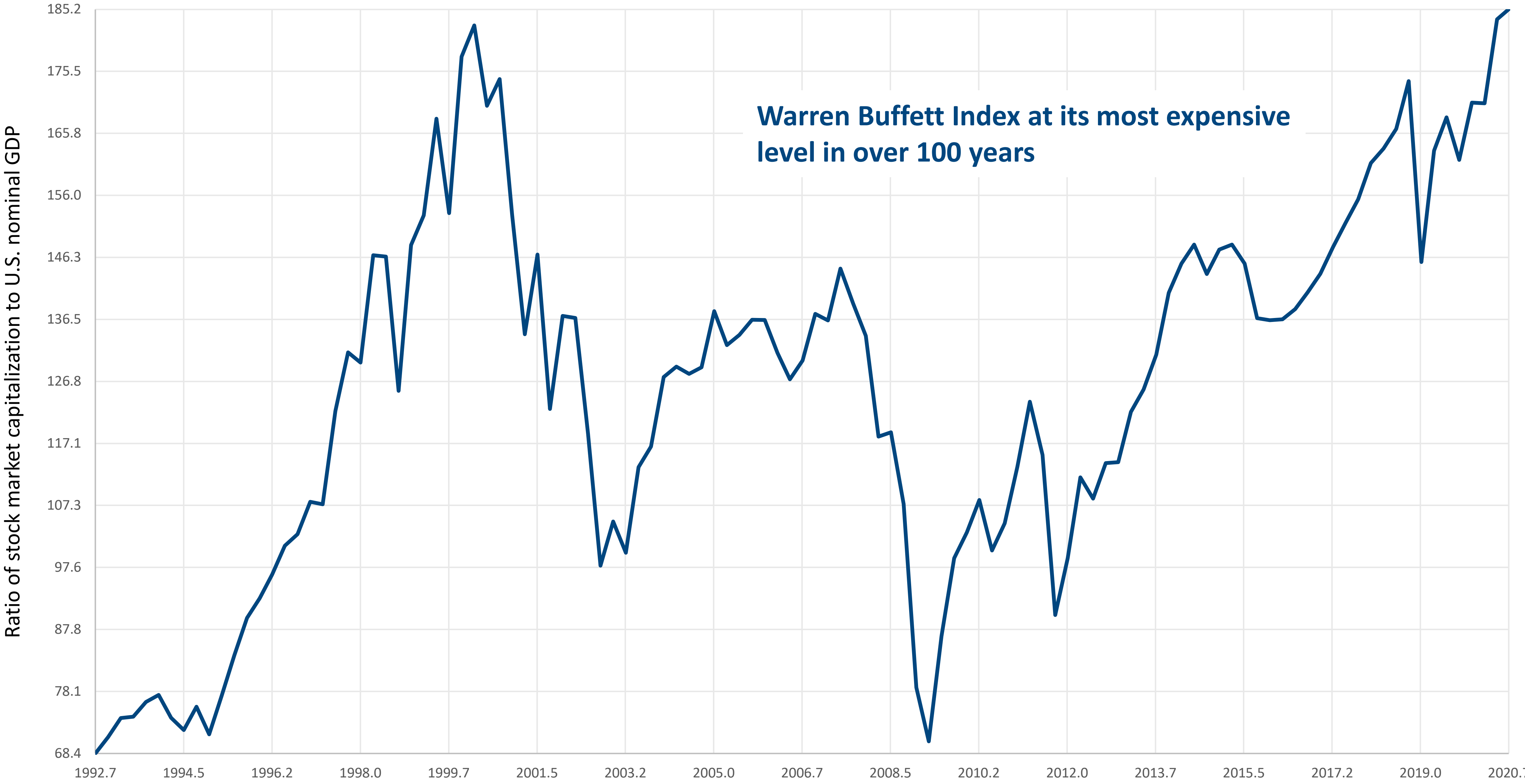
The current bull market is long in the tooth



The next bear market is closer than one might think - continued

The next bear market might be more severe than the average

Stocks are richly priced relative to the U.S. economy (GDP)



Great past performance provides NO basis for future success

One of the very best bond funds

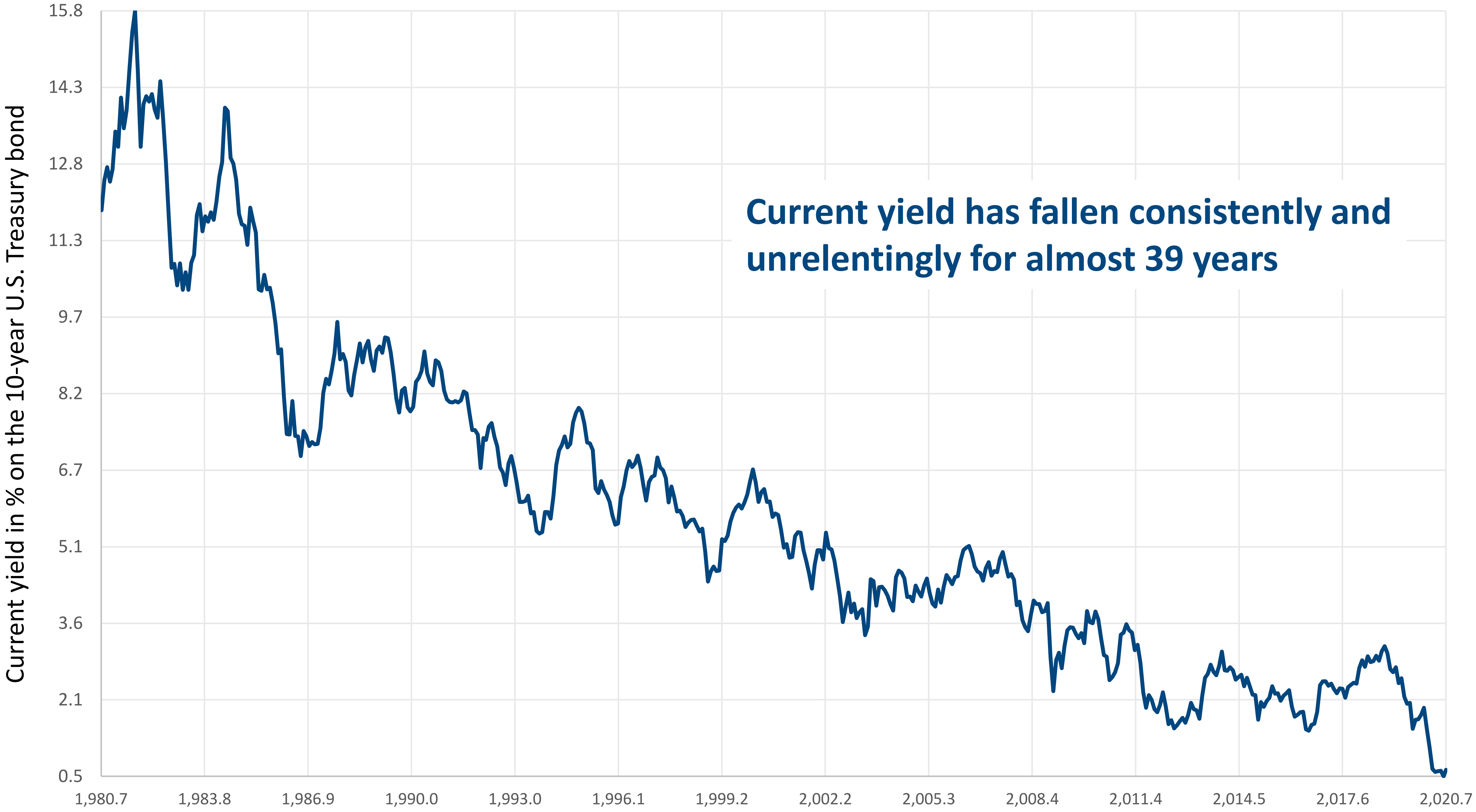
Vanguard Long-Term Investment Grade Bond Fund
(VWESX)

14.2%	year to date (through Aug 23rd)
22.5%	over last year
9.9%	per year, last 5 years
8.6%	per year, last 10 years
8.7%	per year, since inception (more than 37 years)

Returns other than year-to-date are as of July 31, 2020

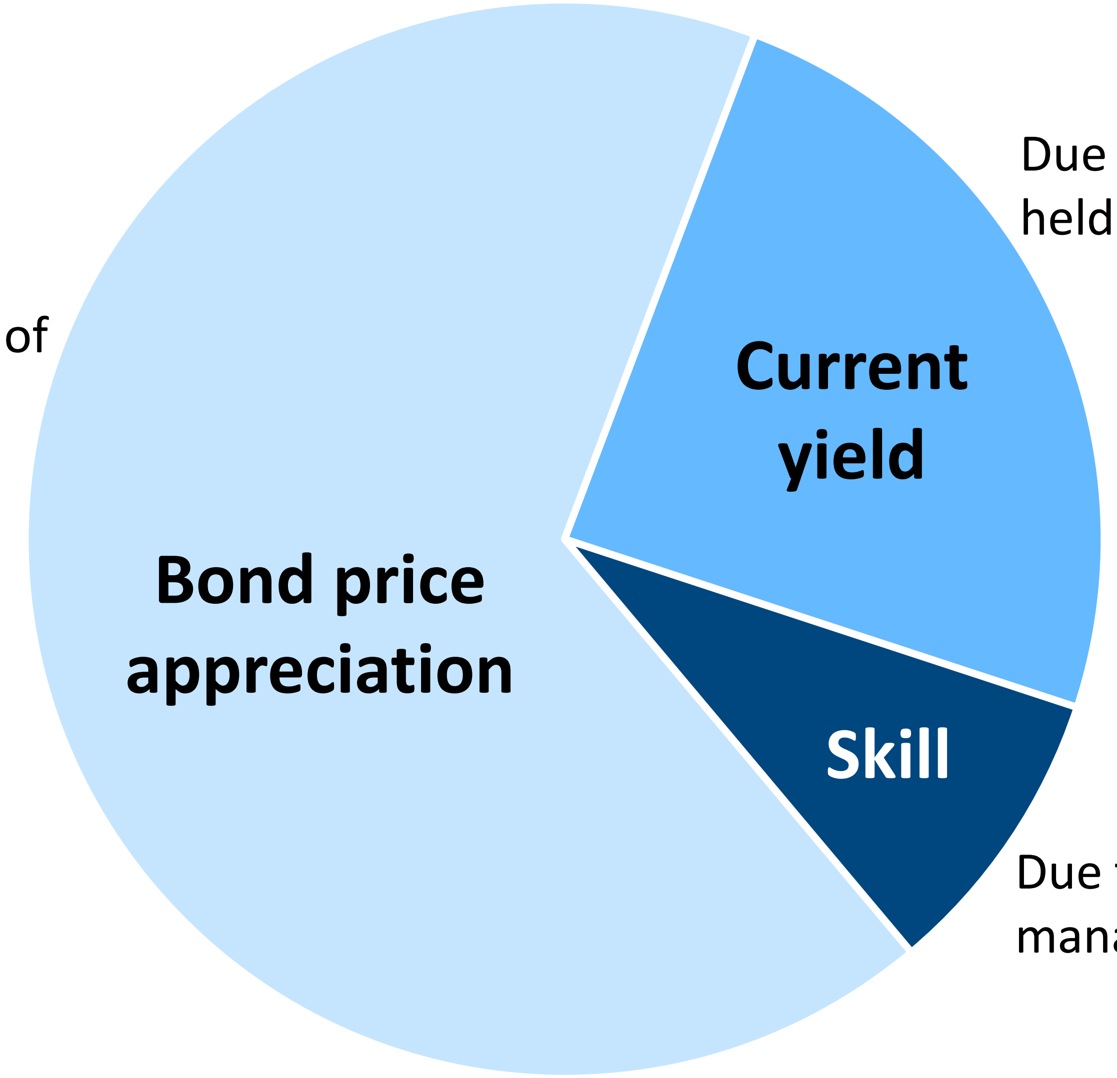
See Disclosure # 9 on the last page

Past performance is explained, primarily by declining interest rates



Where has great performance come from . . . since late-1981

Due to the decline in the level of interest rates since 9/30/1981



Due to the current yield on the bonds held within the portfolio

Due to the bond manager's skill

Great past performance provides NO basis for future success - continued

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Returns other than year-to-date are as of July 31, 2020

But terrible downside risk . . . when interest rates rise

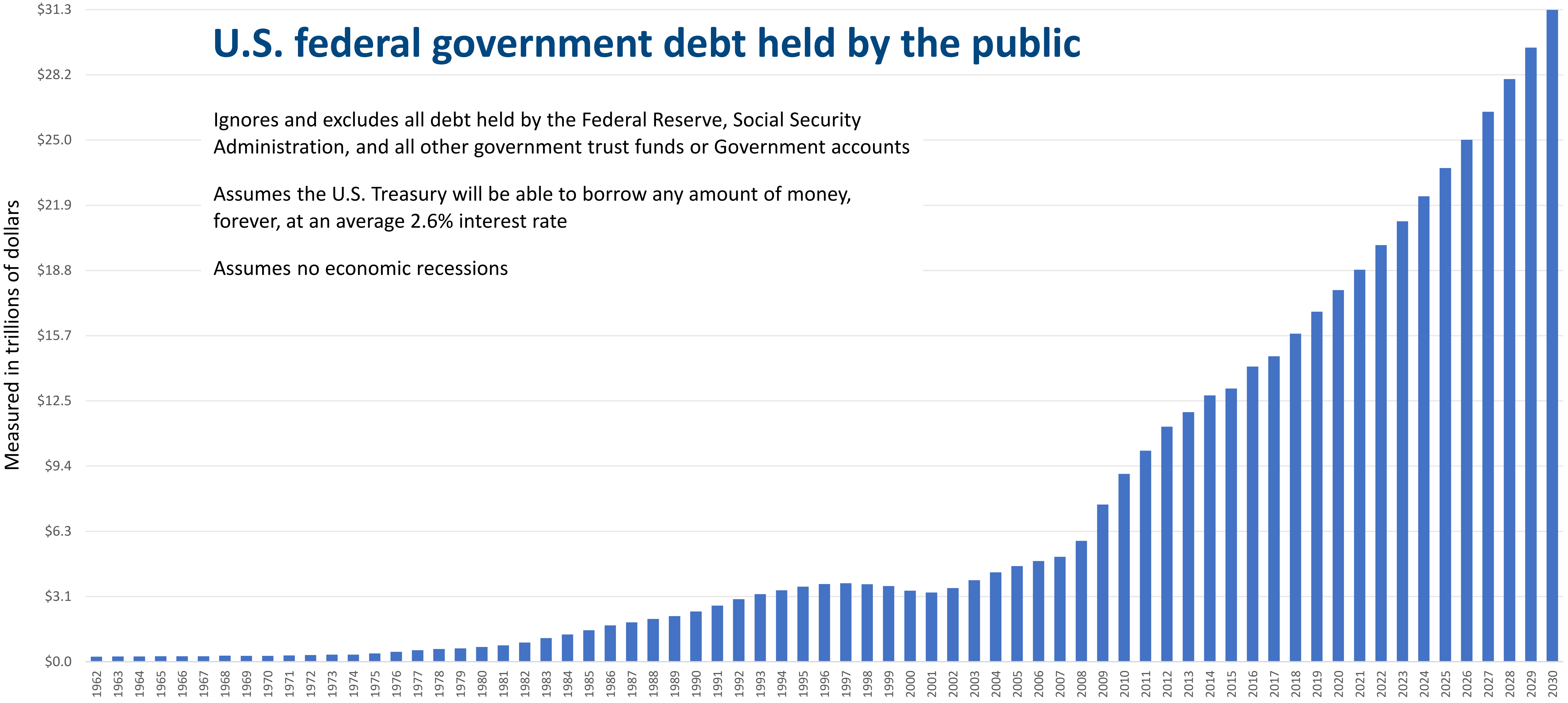
Change in interest rates (from current levels)	Vanguard Bond Fund (VWESX)
-25bps	**+4%**
+25bps	**-4%**
+50bps	**-8%**
+100bps	**-15%**
+200bps	**-31%**
+250bps	**-38%**

Based on where interest rates stood on August 23, 2020
Assumes an instantaneous change in the level of interest rates, i.e., overnight

What issues define the environment today and over the next 15 years

Govt Deficit	Inflation	Interest rates	U.S. Dollar	Politics
Large and rapidly growing Abandonment of fiscal discipline or prudence Gigantic future entitlement programs	Rising inflationary expectations Precious metals prices setting new record highs	Large increases Expectations for rising rates many years into the future	Falling U.S. Dollar Growing dependence on other nations funding our deficits	Political turmoil Rise of polarizing factions Tribalism

An optimistic forecast for future federal government deficits



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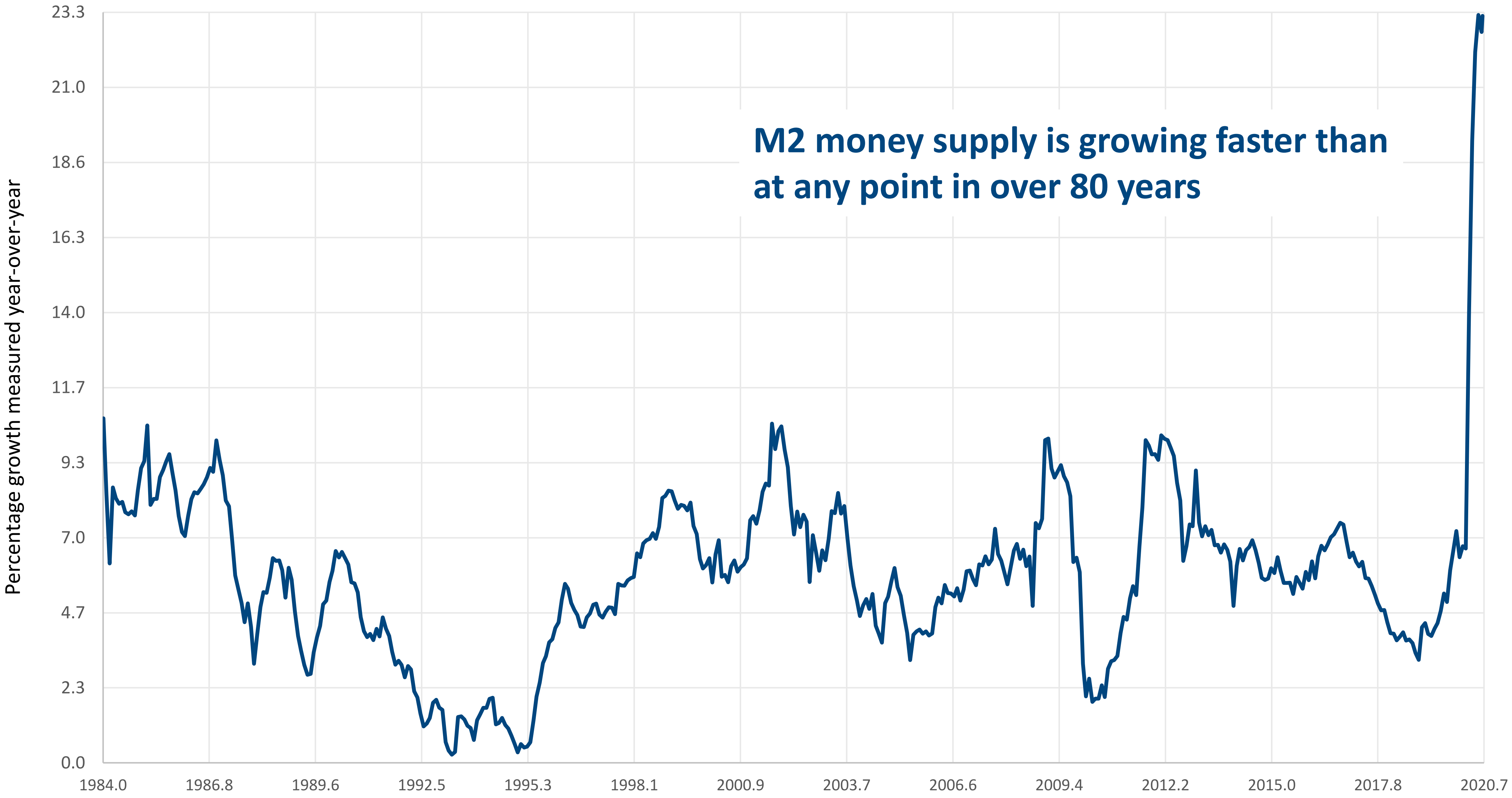
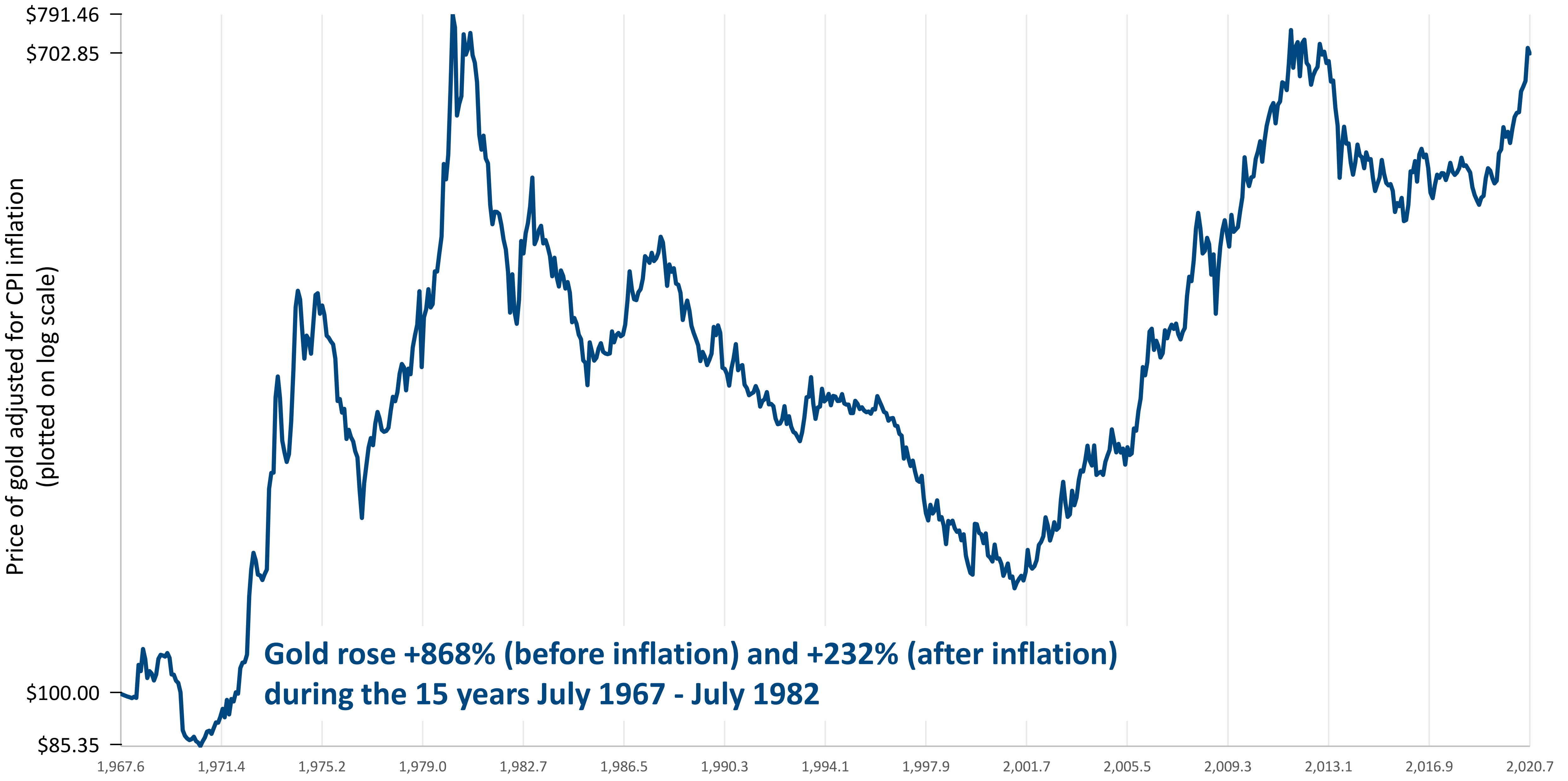
The U.S. Federal Reserve is printing money at an accelerating pace



Gold prices have started to rise again, much as they did back in 1967

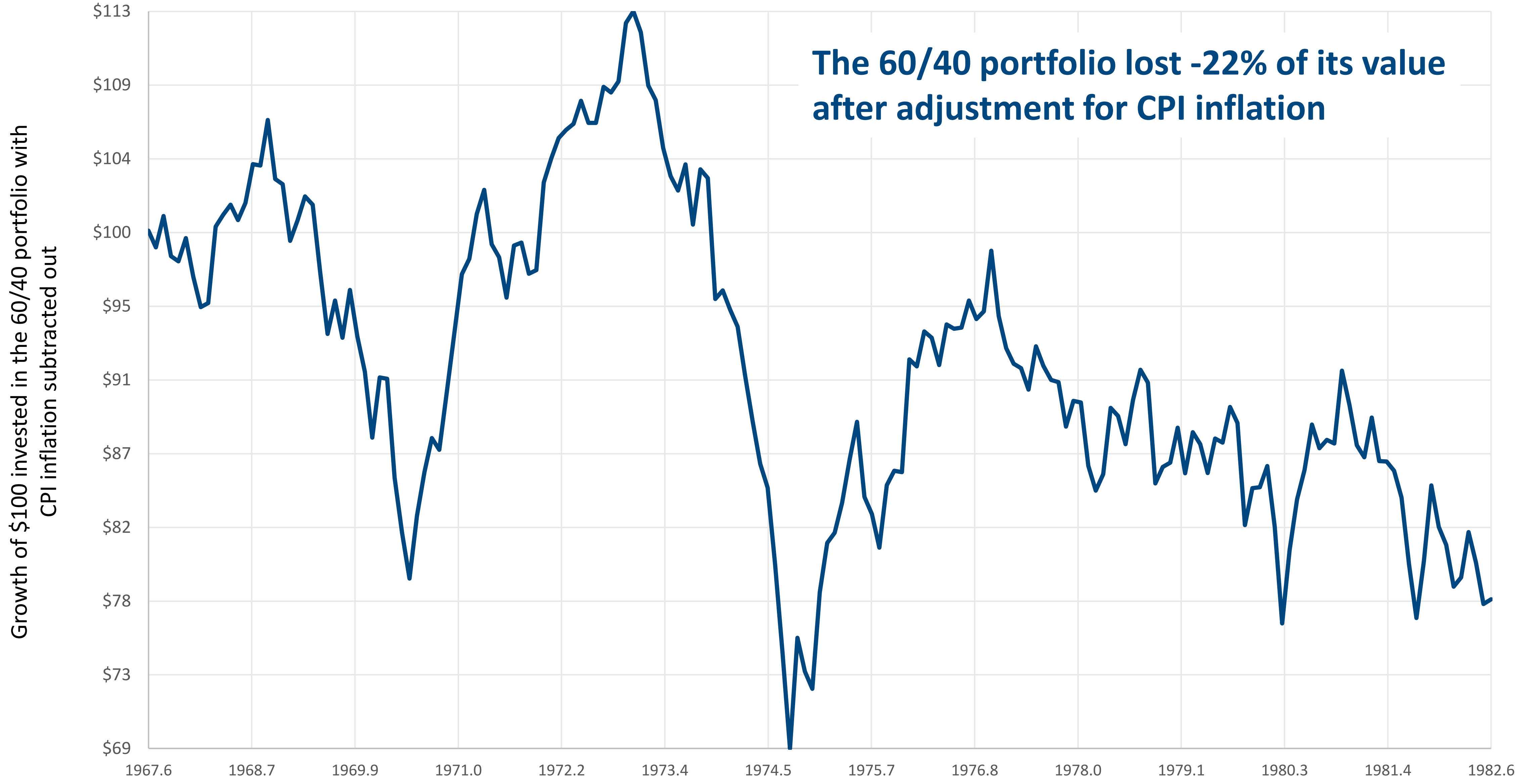


See Disclosure # 14 on the last page

What issues defined the 15 years from 1967 through 1982

Govt Deficit	Inflation	Interest rates	U.S. Dollar	Politics
Large and rapidly growing Abandonment of fiscal discipline or prudence Gigantic future entitlement programs	Rising inflationary expectations Precious metals prices setting new record highs	Large increases Expectations for rising rates many years into the future	Falling U.S. Dollar Growing dependence on other nations funding our deficits	Political turmoil Rise of polarizing factions Tribalism

How did the 60/40 portfolio perform during the 15 years 1967-1982



Bonds can’t successfully play their necessary role

One last way of understanding the problem

As interest rates fall

- Near-zero interest rates have eliminated bond’s portfolio functionality
- Cash flow and equity hedging are virtually eliminated
- As rates have approached zero
  - Duration (interest rate sensitivity) has skyrocketed
  - Income has evaporated
  - Ability of bonds to offset stock losses during bear markets is gone

- This graph shows the *"Point of Zero Return"* for a 10-Year Treasury. How much cushion to higher rates a bond has before its 12-month return falls to zero, currently at 6bps

Possible solutions

Each offers a different set of pros and cons

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Potential remedies for the future failure of 60/40 portfolios

Tactical asset allocation

While strictly avoiding predicting market direction or turning points

Extremely patient, bottom-up stock picking

Maintaining dry-powder in ultra-short Treasuries

Ownership of commercial real estate

Bricks & mortar

Active bond picking

Virtually impossible to offer a commercially viable product

Pros and cons for each possible solutions

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MOST likely to succeed ⟷ **LEAST likely to succeed**

Tactical asset allocation (sector rotation)	Patient bottom-up stock picking (deep value with dry-powder)	Private non-traded real estate (bricks & mortar)	Active bond picker (mutual fund)
• Continuously adapts and aligns with the changing environment • Greatest opportunity to enhance returns and mitigate bear market collapse • Hunts cross the entire range of possible asset categories	• Tremendous outperformance opportunity for the patient investor • Based on the common sense logic of *“Buying $1 worth of assets for 50¢”*	• Potential to earn attractive premiums by accepting the risks associated with illiquidity, manager-skill, and specific property-types	• Opportunity at three distinct levels: asset-class, sector, and individual issuer
• Does not track any performance index • Terribly tax inefficient • Fails miserably in the short-run (e.g., three or four years)	• Requires a full market cycle (one complete bull and bear market) • Does not track any performance index • Greater week-to-week volatility	• Rising cap rates pose a serious threat • High hidden expense ratios • Requires unusually restrictive manager screening and selection processes • Fails to get you out of stocks	• Virtually impossible to offer a commercially viable mutual fund following such a strategy • Successful active bond managers pursuing such an objective quickly turn into tactical asset allocators • Fails to get you out of stocks

The Julex Capital solution

My favorite

Investment approach - multi strategies

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Dynamic Series

60% | 40%

Domestic Model
- Forecasting + Trend

International Model
- Trend Following

Benefits of Multi Strategies:

- Better risk-adjusted return
- Model risk mitigation

Investment approach - multi strategies, continued

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Domestic Model	International Model
Identify Market Regime (Risk on/Weak Risk On/Risk off)	**Detect Market Trends from Noisy Data**
Economic Fundamentals, Trends, Liquidity and Volatility	Multi-Resolution Trend Analysis
↓	↓
Invest in Sectors with the Strongest Trends	**Invest in Countries with Positive Trends**
Multi-period Momentum Decision Process	Adapt the Lengths of Trends to Volatility
↓	↓
Reduce Return Volatility	**Reduce Return Volatility**
Volatility Weighted Portfolio Construction	Volatility Weighted Portfolio Construction

Investment universe

COUNTRY ETFs

- Australia
- Sweden
- Germany
- Hong Kong
- Italy
- Japan
- Switzerland
- Netherlands
- Spain
- France
- UK
- Canada
- Singapore
- India
- Taiwan
- Mexico
- Korea
- Brazil
- China
- Russia
- EM Income
- EM Index
- DM Index

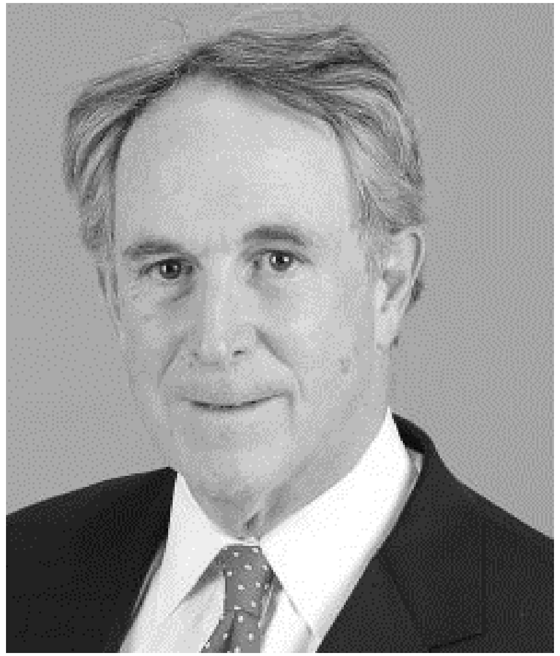
US SECTOR ETFs

- Materials
- Energy
- Financial
- Industrials
- Technology
- Consumer Staples
- Consumer Discretionary
- Utilities
- Healthcare
- Real Estate
- Communications
- Bank
- Biotech
- Internet
- Software
- Semiconductor
- Large Cap Growth
- Large Cap Value
- Mid Cap Growth
- Mid Cap Value
- Small Cap Growth
- Small Cap Value
- US Large Cap

FIXED INCOME ETFs

- US Aggregate Bond
- US TIPS
- US Treasuries
- US Long-Term Treasuries
- US Short Term Treasuries
- Treasury Bills
- High Yield
- US Investment Grade Corp.
- International Bonds
- EM Bonds (USD)
- EM Bonds (Local)

For more information contact



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