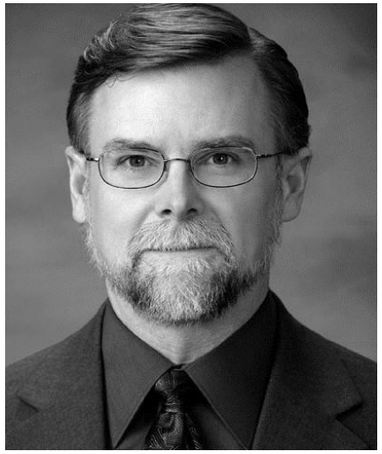
Death of the 60/40 portfolio - An update

Rob Brown, PhD, CFA

Julex Capital Advisory Board Member, Website www.robbrownonline.com



40 Grove Street, Suite 140, Wellesley, MA 02482

Phone 781-489-5398

Email info@julexcapital.com

Web www.julexcapital.com

> ***"Plan not to lose . . . only then . . . plan to win"***
>
> Unknown

What is a “60/40 portfolio”?

It’s the definition of “what is”

What is the “60/40 portfolio”

JULEX CAPITAL

- It’s a general label . . . designating a portfolio that
- Relies primarily on stocks and bonds
- Makes asset class adjustments/changes that are too small to
  - Mitigate future stock bear markets
  - Mitigate future bond bear markets
- If actively managed, relies on
  - Individual stock picking
  - Individual bond picking
  - Small asset class (or sector changes)
  - That if successful will beat an index . . . But will do nothing to mitigate stock or bond bears
- Is how 95% of the industry’s portfolios are managed

What is the “60/40 portfolio”

- Is based on what is called

- *“Modern Portfolio Theory”* or *“MPT”*

- As Burton Mailkel jokes
- When you say *“MPT”* quickly . . . it comes out *“Empty”*

What's the problem?

Why worry . . .

Everything has been going remarkably well

Well . . . do you live in the past . . . or do you prepare for the future?

So what's the problem?

- Is the 60/40 portfolio dead?
- YES it is
- WHY . . . because we're going to have a simultaneous stock and bond bear market
- WHEN . . . I don't know and no one else does either . . . but, I'm not waiting around

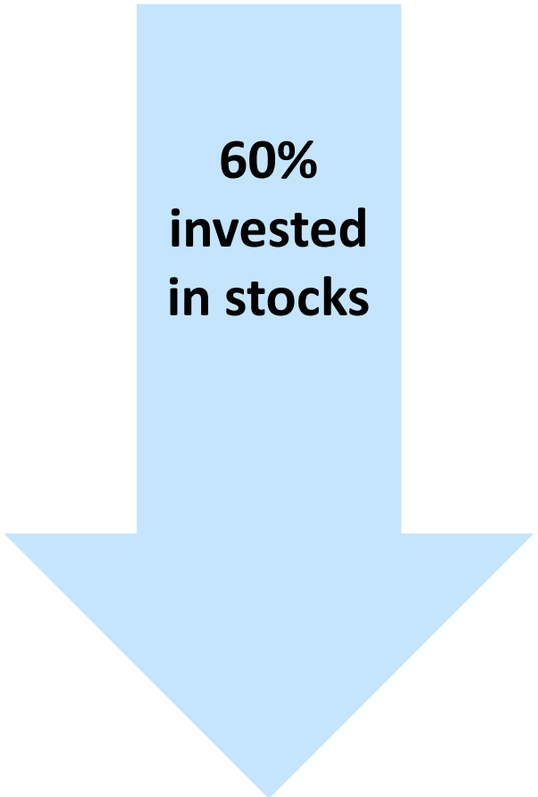
So what's the problem?

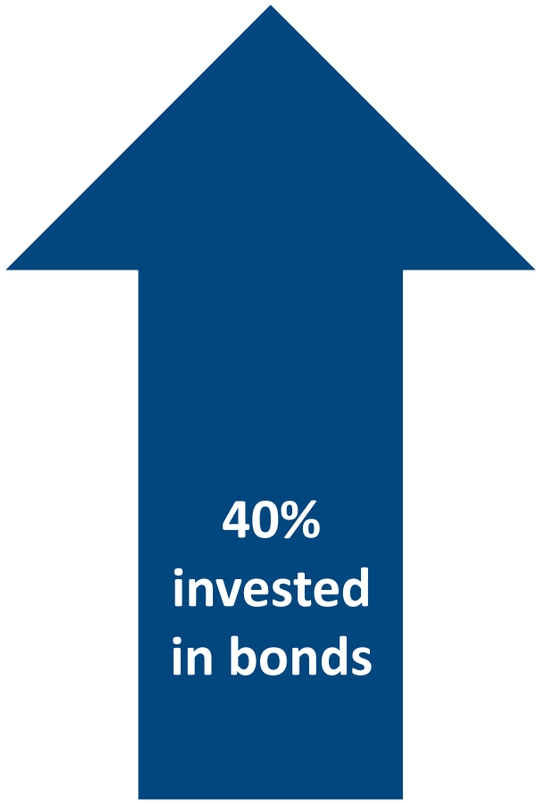
- Is the 60/40 portfolio dead?
- YES it is
- WHY . . . because we're going to have a simultaneous stock and bond bear market
- WHEN . . . I don't know and no one else does either . . . but, I'm not waiting around
- Will the "60/40" eventually come back
- Yes, absolutely . . . but first . . . it must die

Why the 60/40 portfolio works so well

JULEX CAPITAL

Stocks collapse during periodic bear markets





Interest rates generally decline during bear markets, driving bond prices higher

So what comes next?

- Stocks fall -41% . . . . an average stock bear market
- Bonds fall -36% . . . . an average bond bear market
- Therefore your client's 60/40 portfolio falls -39%

Are you in denial about the “60/40 portfolio”?

OK . . . Let’s back this claim up with supporting evidence

Putting some flesh on the bone

History of stock bulls

JULEX CAPITAL

Bull markets for inflation-adjusted U.S. stocks since 1846

	Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BULL market
	51	6.67	Dec 1846	Aug 1853	7.6	61	6.4
	49	2.08	Nov 1854	Dec 1856	17.4	72	21.0
	287	6.75	Oct 1857	Jul 1864	19.4	62	22.2
	177	11.00	Mar 1865	Mar 1876	10.6	67	9.7
	1057	29.25	Jun 1877	Sep 1906	10.9	59	8.7
	79	4.92	Nov 1907	Oct 1912	12.1	63	12.6
	50	2.08	Oct 1914	Nov 1916	9.6	76	21.7
	709	8.67	Dec 1920	Aug 1929	13.7	72	27.3
	382	4.75	May 1932	Feb 1937	38.5	68	39.2
	65	1.50	Mar 1938	Sep 1939	32.8	61	39.8
	168	4.08	Apr 1942	May 1946	12.1	78	27.3
	1145	20.75	Feb 1948	Nov 1968	12.3	66	12.9
	60	2.50	Jun 1970	Dec 1972	11.0	70	20.8
	312	12.92	Sep 1974	Aug 1987	15.7	55	11.6
	512	12.75	Nov 1987	Aug 2000	13.5	66	15.3
	81	5.08	Sep 2002	Oct 2007	10.0	70	12.3
	515	12.50	Feb 2009	Aug 2021	13.9	68	15.6
Median BULL market	177	6.67			12.3	67	15.6
Mean BULL market	335	8.72			15.4	67	19.1

Average stock bull is pretty good

JULEX CAPITAL

Bull markets for inflation-adjusted U.S. stocks since 1846

	Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BULL market
Median BULL market	177	6.67			12.3	67	15.6
Mean BULL market	335	8.72			15.4	67	19.1

Most recent stock bull was MUCH better than average

JULEX CAPITAL

Bull markets for inflation-adjusted U.S. stocks since 1846

	Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BULL market
	515	12.50	Feb 2009	Aug 2021	13.9	68	15.6
Median BULL market	177	6.67			12.3	67	15.6
Mean BULL market	335	8.72			15.4	67	19.1

History of stock bears

JULEX CAPITAL

Bear markets for inflation-adjusted U.S. stocks since 1846

	Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BEAR market
	-30	1.25	Aug 1853	Nov 1854	27.6	27	-25.1
	-31	0.83	Dec 1856	Oct 1857	19.2	10	-36.4
	-35	0.67	Jul 1864	Mar 1865	32.4	38	-47.1
	-32	1.25	Mar 1876	Jun 1877	7.8	7	-26.2
	-37	1.17	Sep 1906	Nov 1907	13.8	14	-32.7
	-27	2.00	Oct 1912	Oct 1914	11.0	38	-14.8
	-48	4.08	Nov 1916	Dec 1920	15.9	41	-14.8
	-79	2.75	Aug 1929	May 1932	37.3	36	-43.7
	-50	1.08	Feb 1937	Mar 1938	31.6	23	-47.1
	-39	2.58	Sep 1939	Apr 1942	19.3	42	-17.3
	-37	1.75	May 1946	Feb 1948	14.5	29	-23.4
	-35	1.58	Nov 1968	Jun 1970	14.8	26	-24.1
	-52	1.75	Dec 1972	Sep 1974	15.2	14	-34.2
	-30	0.25	Aug 1987	Nov 1987	33.9	0	-76.3
	-47	2.08	Aug 2000	Sep 2002	17.8	36	-26.4
	-52	1.33	Oct 2007	Feb 2009	19.2	25	-42.1
	?	?	Aug 2021	?	?	?	?
Median BEAR market	-37	1.46			18.5	26	-29.6
Mean BEAR market	-41	1.65			20.7	25	-33.2

Average stock bear is painful and long-lasting

JULEX CAPITAL

Bear markets for inflation-adjusted U.S. stocks since 1846

	Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BEAR market
Median BEAR market	-37	1.46			18.5	26	-29.6
Mean BEAR market	-41	1.65			20.7	25	-33.2

Average stock bear is painful and long-lasting

JULEX CAPITAL

Bear markets for inflation-adjusted U.S. stocks since 1846

	Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BEAR market
Median BEAR market	-37	1.46			18.5	26	-29.6
Mean BEAR market	-41	1.65			20.7	25	-33.2

Bond bulls - history and the average

JULEX CAPITAL

Bull markets for inflation-adjusted U.S. bonds since 1845

	Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BULL market
	184	17.58	Aug 1845	Mar 1863	5.3	70	6.1
	1075	43.08	Nov 1865	Dec 1908	3.5	75	5.9
	379	20.67	May 1920	Jan 1941	5.2	73	7.9
	26	7.75	Aug 1957	May 1965	2.6	70	3.0
	1008	38.83	Sep 1981	Jul 2020	6.8	61	6.4
Median BULL market	379	20.67			5.2	70	6.1
Mean BULL market	534	25.58			4.7	70	5.9

Bond bears - history and average

JULEX CAPITAL

Bear markets for inflation-adjusted U.S. bonds since 1845

	Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BEAR market
	-22	2.67	Mar 1863	Nov 1865	6.1	31	-9.1
	-50	11.42	Dec 1908	May 1920	4.8	41	-5.9
	-31	16.58	Jan 1941	Aug 1957	3.3	45	-2.2
	-40	16.33	May 1965	Sep 1981	6.4	45	-3.0
	?	?	Jul 2020	?	?	?	?
Median BEAR market	-35	13.87			5.4	43	-4.5
Mean BEAR market	-36	11.75			5.1	40	-5.0

Bond bears - history and average

JULEX CAPITAL

Bear markets for inflation-adjusted U.S. bonds since 1845

	Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BEAR market
	-22	2.67	Mar 1863	Nov 1865	6.1	31	-9.1
	-50	11.42	Dec 1908	May 1920	4.8	41	-5.9
	-31	16.58	Jan 1941	Aug 1957	3.3	45	-2.2
	-40	16.33	May 1965	Sep 1981	6.4	45	-3.0
	?	?	Jul 2020	?	?	?	?
Median BEAR market	-35	13.87			5.4	43	-4.5
Mean BEAR market	-36	11.75			5.1	40	-5.0

So what comes next?

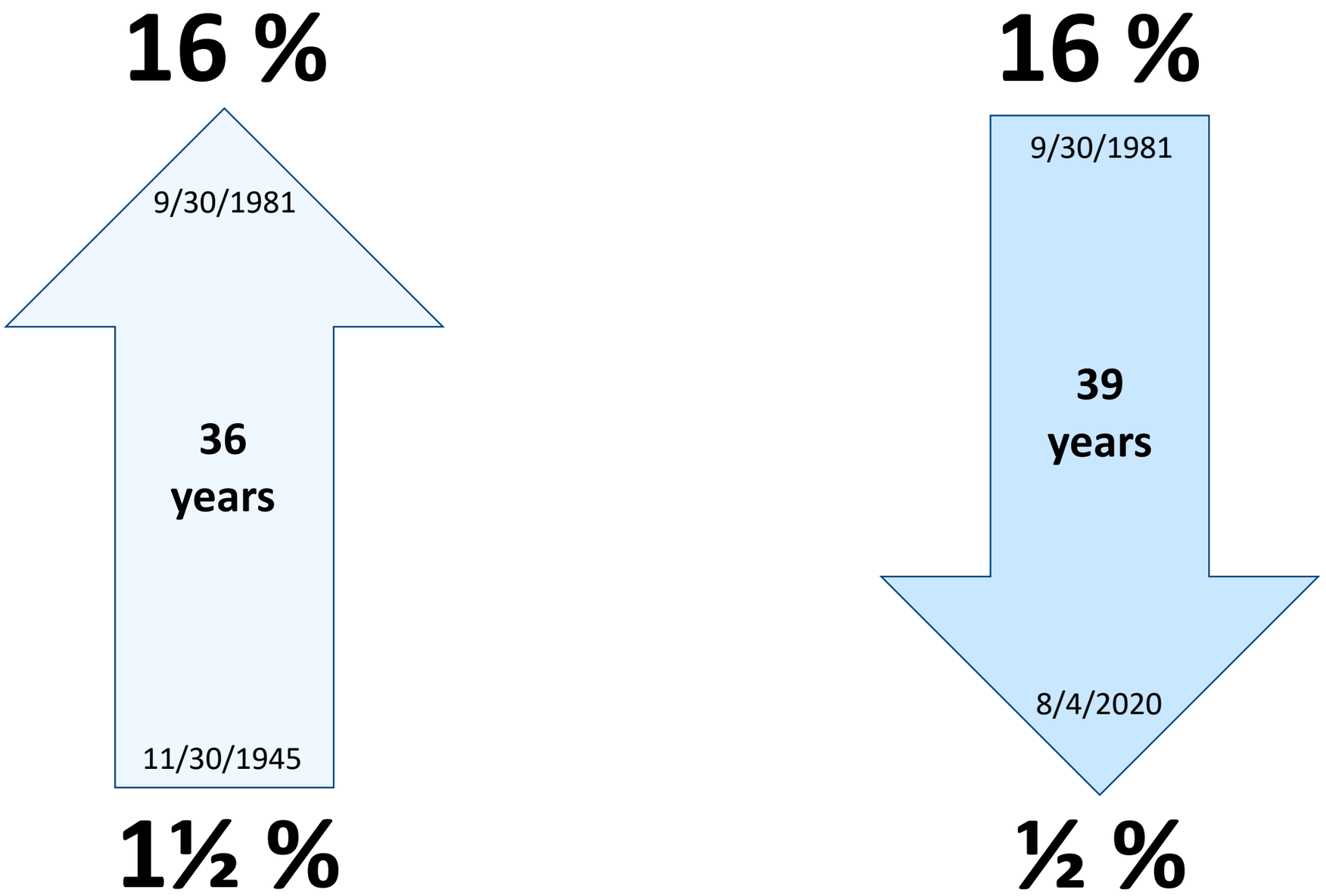
- Stocks fall -41% . . . . an average stock bear market
- Bonds fall -36% . . . . an average bond bear market
- Therefore your client's 60/40 portfolio falls -39%

Why must interest rates go back up?

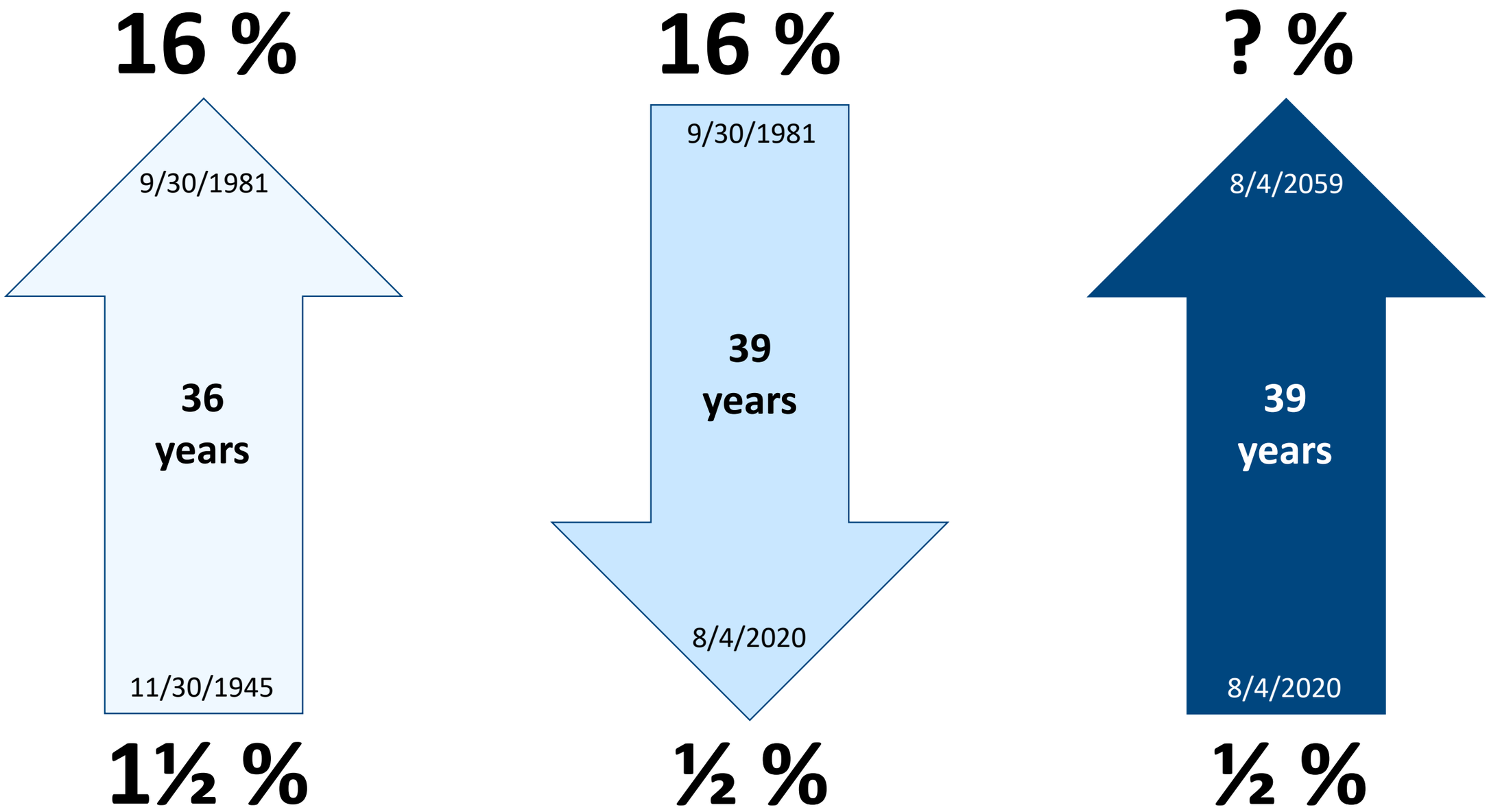
Ya know . . . they are at a 3,000 year low . . . in “nominal” terms

Don’t be an ostrich

Interest rates over the last two cycles



And the next cycle will be . . . . back up again

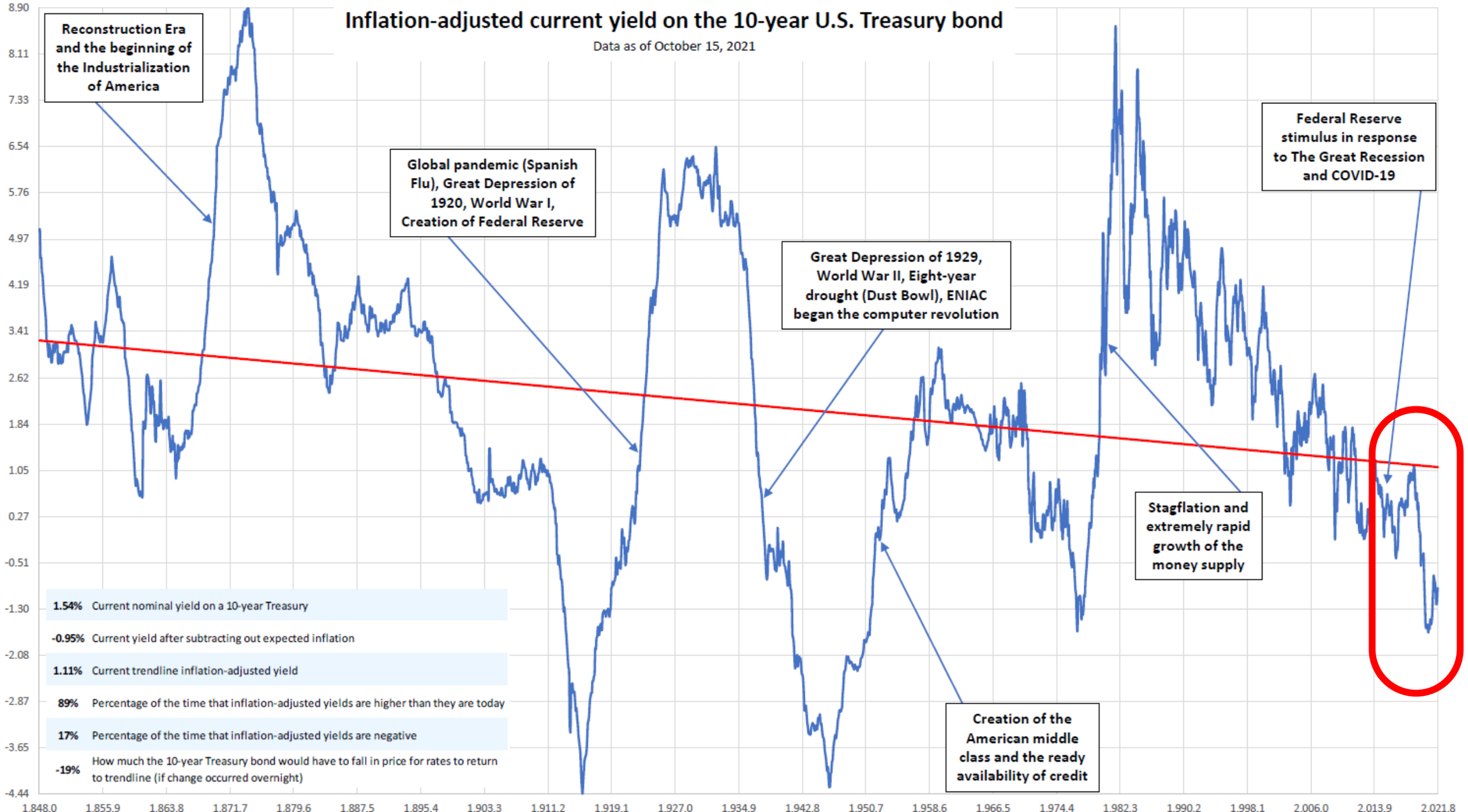


History of interest rates

JULEX CAPITAL

History of interest rates

JULEX CAPITAL



Where are interest rates right now?

1.54%	Current nominal yield on a 10-year Treasury
-0.95%	Current yield after subtracting out expected inflation
1.11%	Current trendline inflation-adjusted yield
89%	Percentage of the time that inflation-adjusted yields are higher than they are today
17%	Percentage of the time that inflation-adjusted yields are negative
-19%	How much the 10-year Treasury bond would have to fall in price for rates to return to trendline (if change occurred overnight)

Where are interest rates right now?

1.54%	Current nominal yield on a 10-year Treasury
-0.95%	Current yield after subtracting out expected inflation
1.11%	Current trendline inflation-adjusted yield
89%	Percentage of the time that inflation-adjusted yields are higher than they are today
17%	Percentage of the time that inflation-adjusted yields are negative
-19%	How much the 10-year Treasury bond would have to fall in price for rates to return to trendline (if change occurred overnight)

Where are interest rates right now?

JULEX CAPITAL

So, just expect a -19% loss

NO!! . . .

Bear markets absolutely always overshoot . . .

Instead, expect a -36% loss

1.54%	Current nominal yield on a 10-year Treasury
-0.95%	Current yield after subtracting out expected inflation
1.11%	Current trendline inflation-adjusted yield
89%	Percentage of the time that inflation-adjusted yields are higher than they are today
17%	Percentage of the time that inflation-adjusted yields are negative
-19%	How much the 10-year Treasury bond would have to fall in price for rates to return to trendline (if change occurred overnight)

But . . . Why must interest rates go back up?

What is the causal reason . . . Why?

Why must interest rates go back up?

- When you lend . . .

- You give up
  - Use of your money
  - Control
  - Possible loss

- So why do you lend your money?
  - You expect to get something **valuable** and **meaningful** in return
  - That requires that you must experience a net gain
  - Therefore, your **return must be greater than taxes and inflation**

Why must interest rates go back up?

- Example
  - Your marginal state/federal tax rate is 45%
  - Inflation is 2.5%
  - You only require to net ¼ % genuine gain

- What must interest rates be?
- Answer is 5.0%
- But to day the interest rate (on 10-year Treasury) is only 1.6%

- What do you think will happen? . . . . the answer is ugly

Any additional reasons that we're entering the next bond-bear?

Inflation

Government policy

Labor market

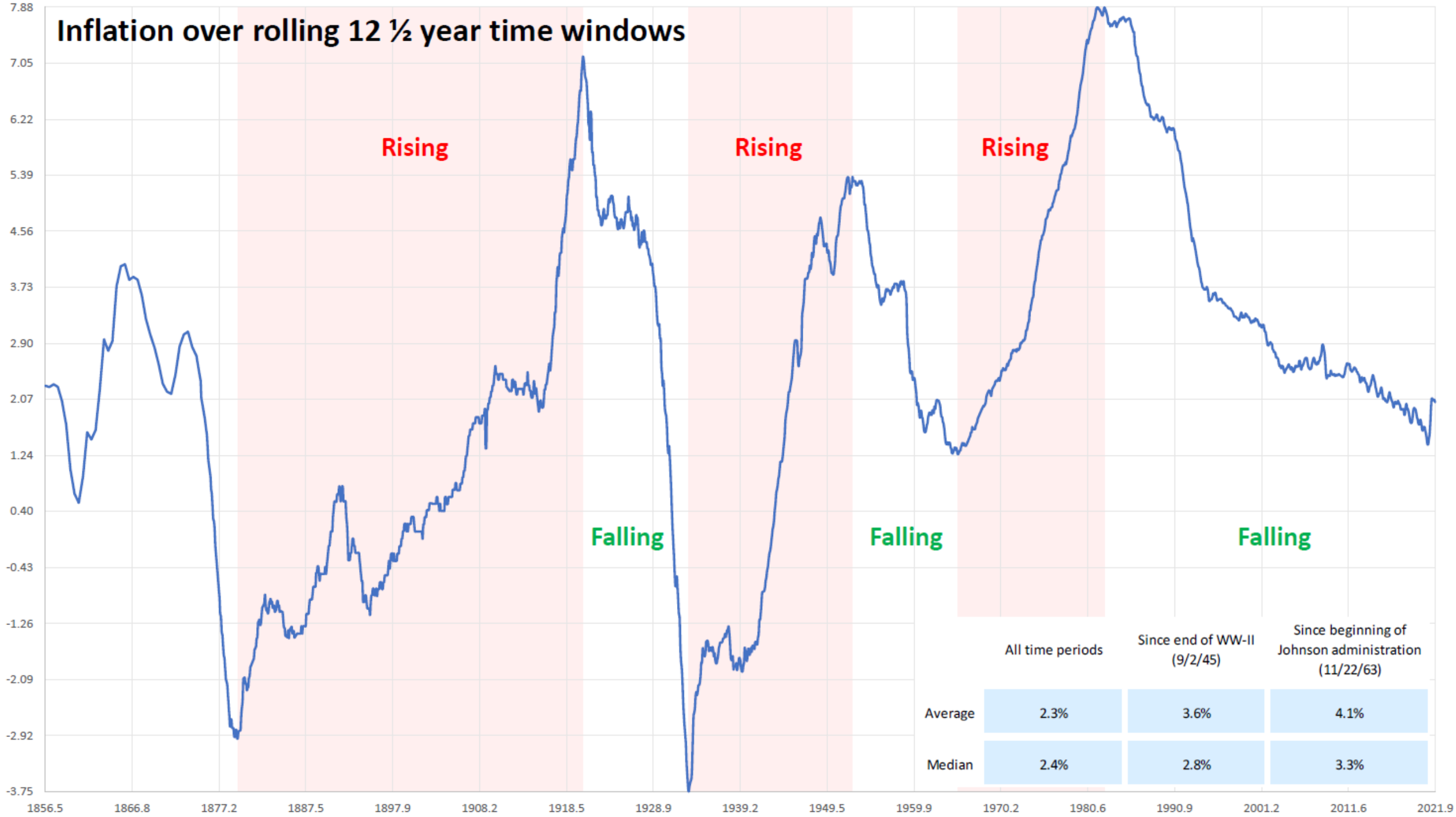
Unspent excess savings

Inflation

The proposed challenge assumes no uptick in inflation

It only gets more ugly . . . if inflation returns

History of inflation



	All time periods	Since end of WW-II (9/2/45)	Since beginning of Johnson administration (11/22/63)
Average	2.3%	3.6%	4.1%
Median	2.4%	2.8%	3.3%

Inflation - if it gets to be a problem

- Mr. Market currently expects inflation to be in "the 2's" for the foreseeable future

- BUT . . . Since the advent of the Johnson administration, inflation has averaged in "the 4's"

- We've been in a long 40-year cycle of declining inflation
- This did not happen by accident

- The next "long-lasting" cycle will be about rising inflation
- Driven by
  - Political instability
  - Social discontent
  - Environmental concerns
  - Wealth and income inequality

Government policy

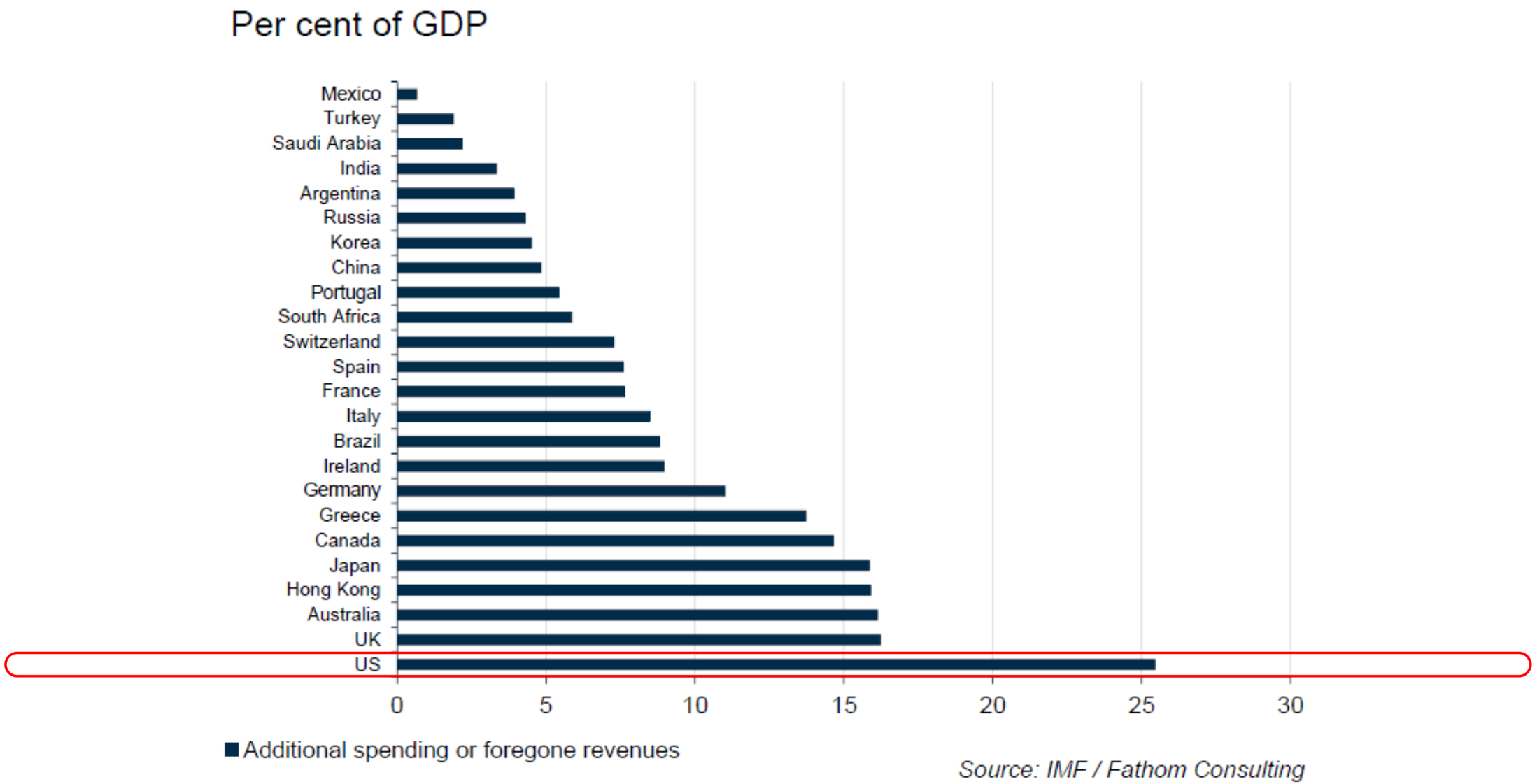
Chemotherapy is never . . . a free-ride

Faust had to eventually pay up

Which country went “the most extreme” ?

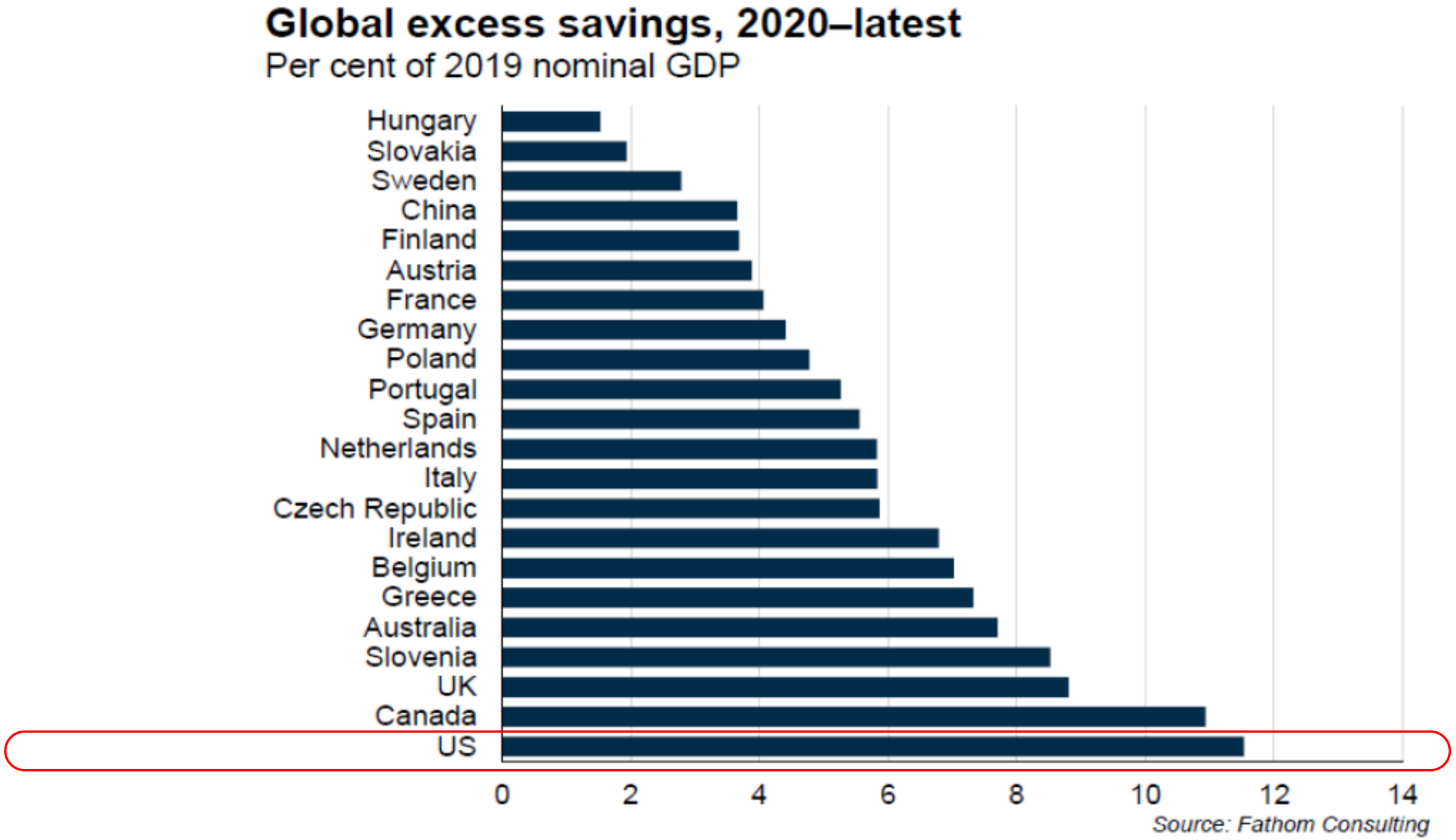
JULEX CAPITAL

Global pandemic-related fiscal stimulus



Source: IMF / Fathom Consulting

And it showed up in savings

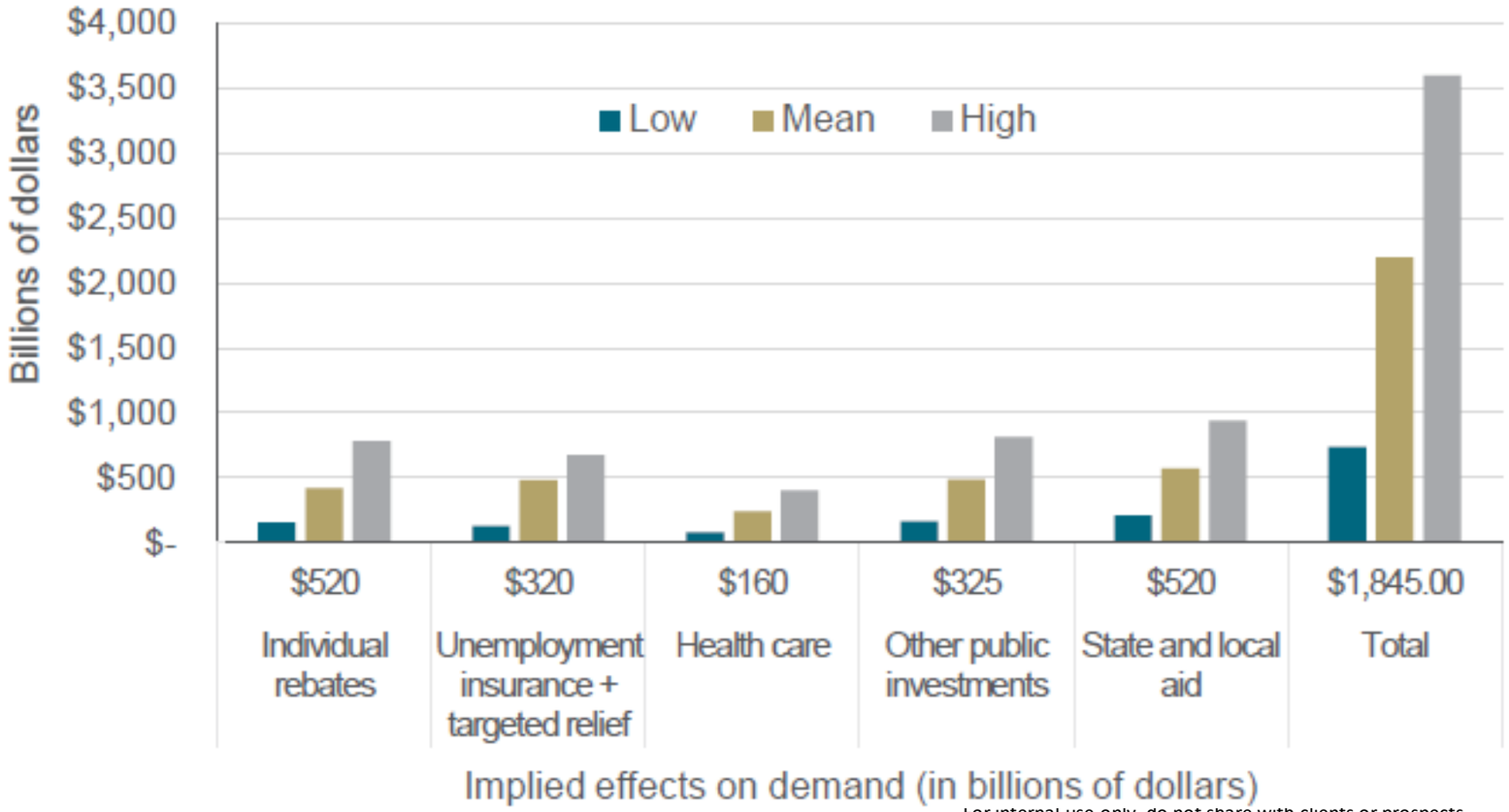


We stimulated and it is closing the "output gap"

JULEX CAPITAL

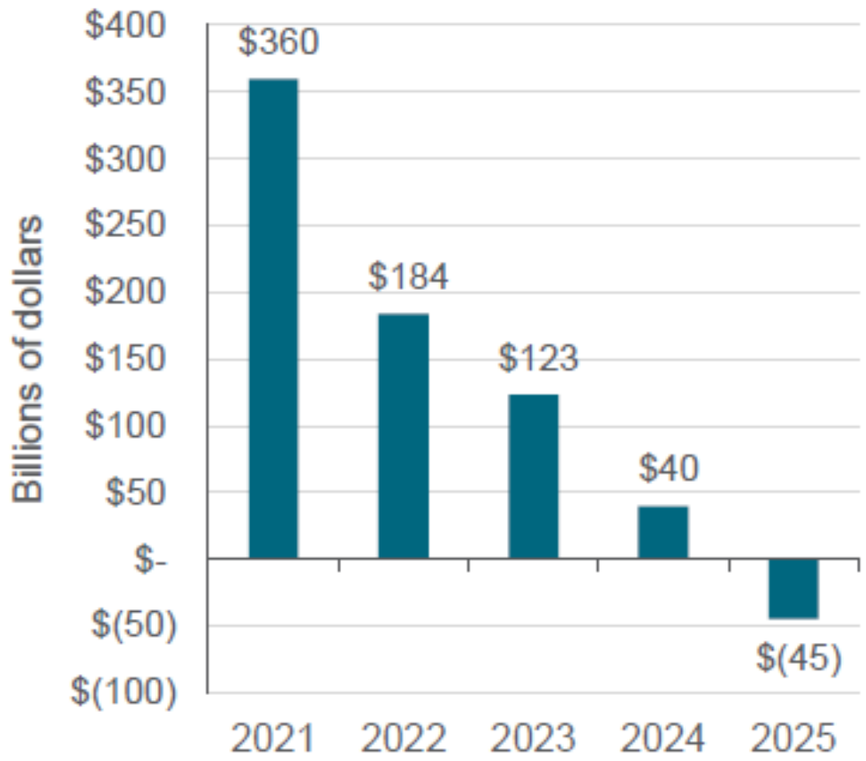
Multiplying effects of the recent stimulus are uncertain, but could be large…

Estimated aggregate demand stimulated by Biden administration's $1.9 trillion relief package by program



And easily fill estimated output gaps well into the future

CBO estimates of the real output gap

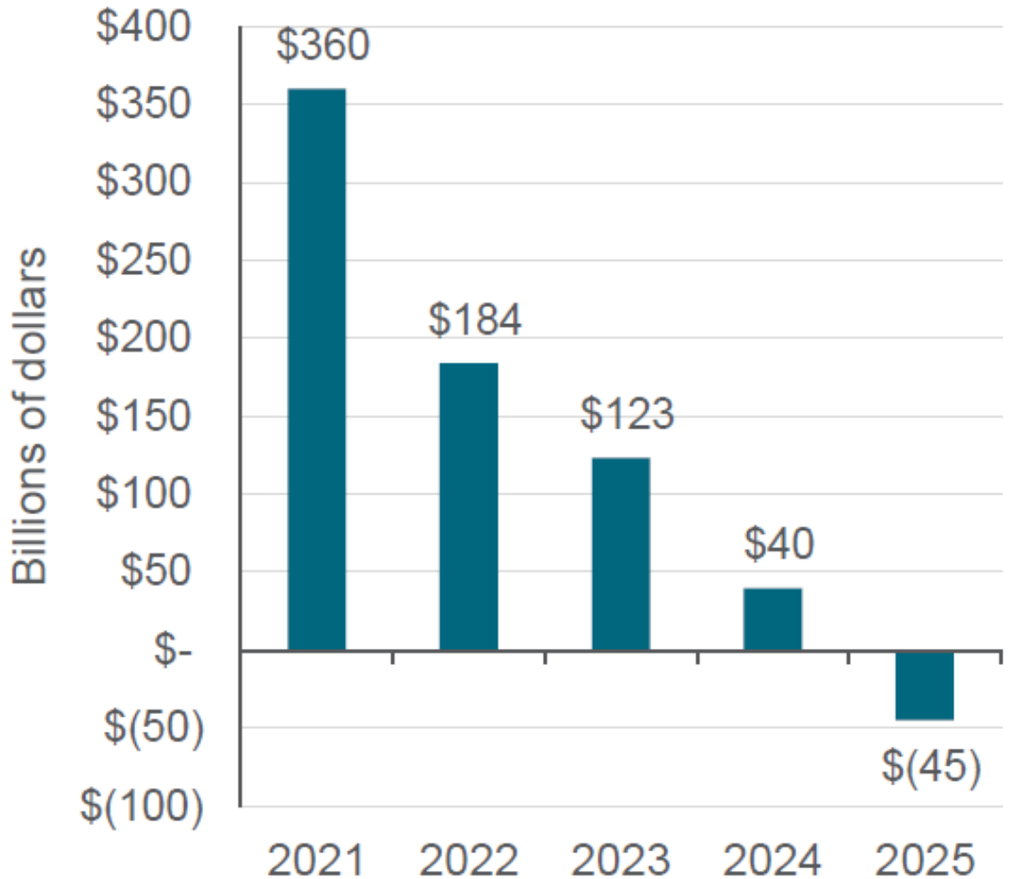


The “output gap” is projected to go negative by 2025

JULEX CAPITAL

And easily fill estimated output gaps well into the future

CBO estimates of the real output gap



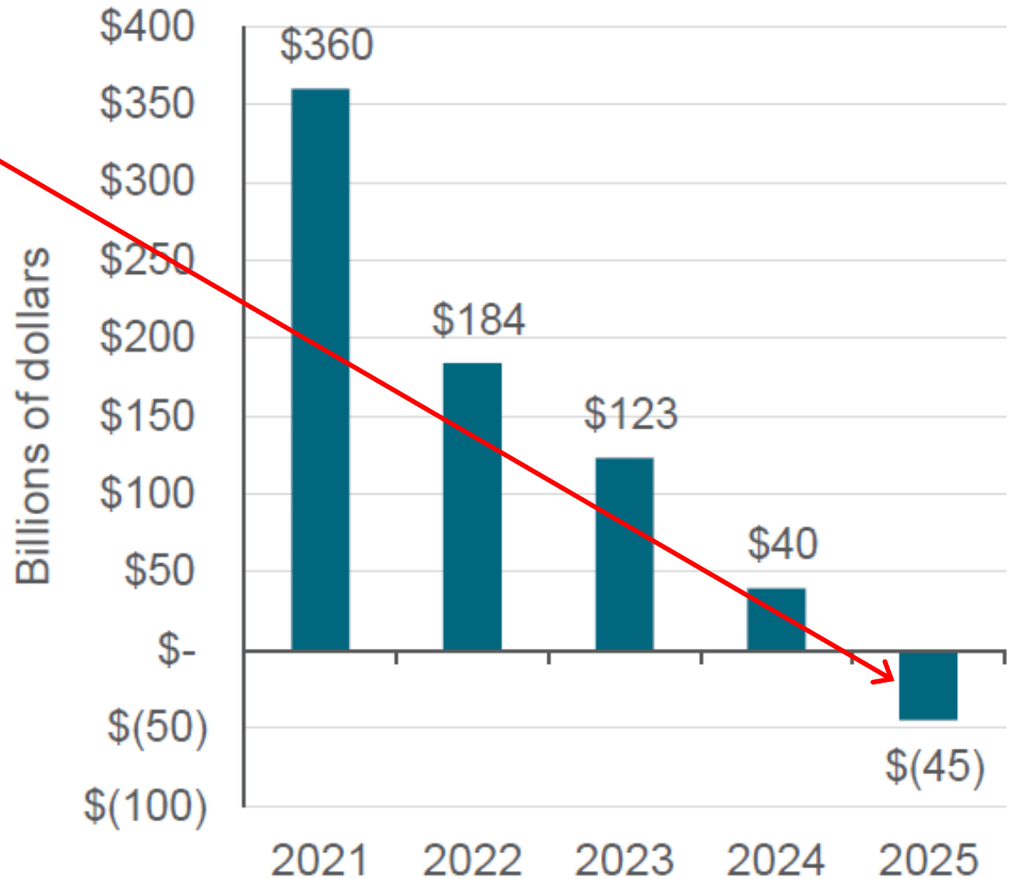
The “output gap” is projected to go negative by 2025

And <u>if</u> that is what occurs . . .

Then expect a very sizable increase in interest rates

And easily fill estimated output gaps well into the future

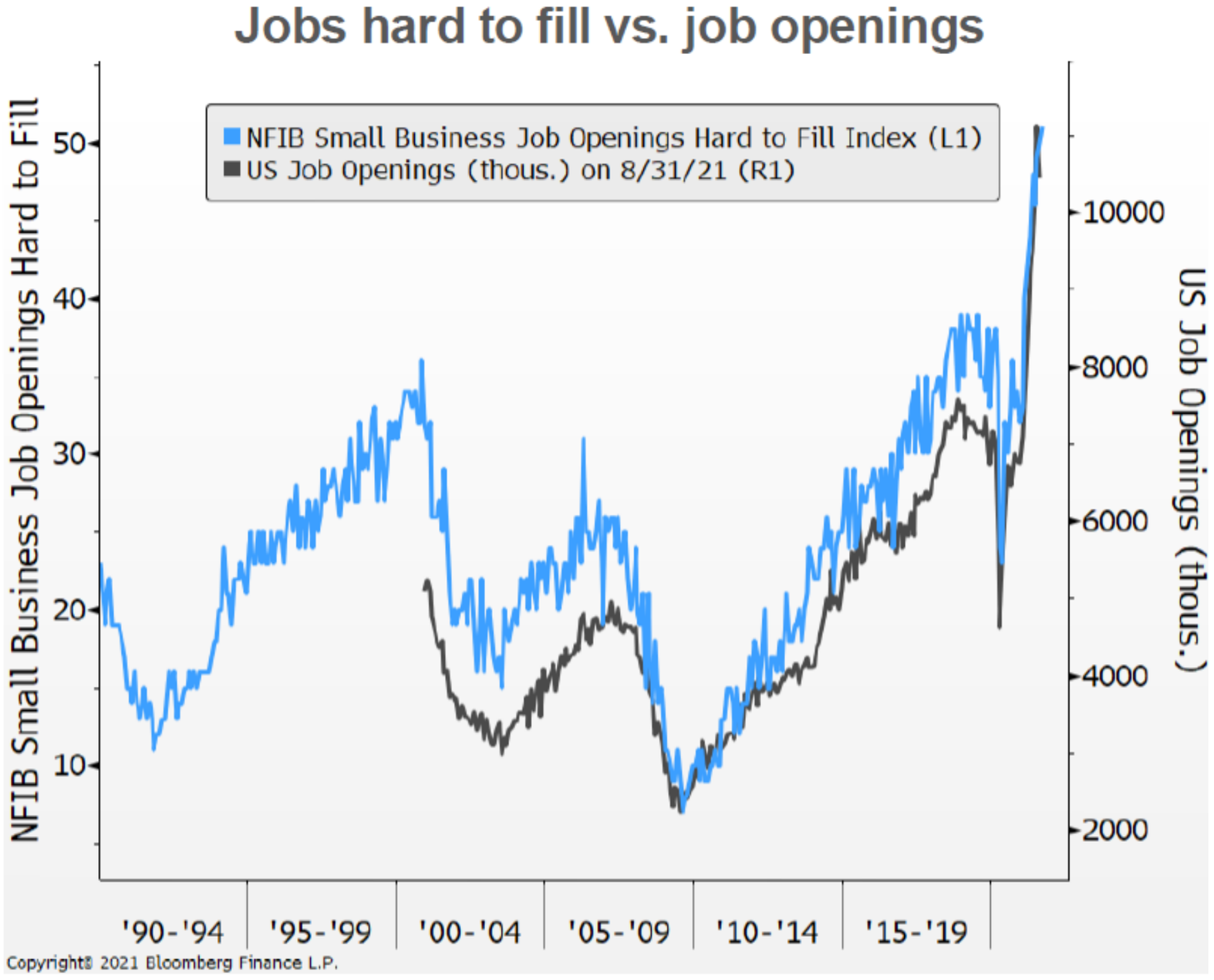
CBO estimates of the real output gap



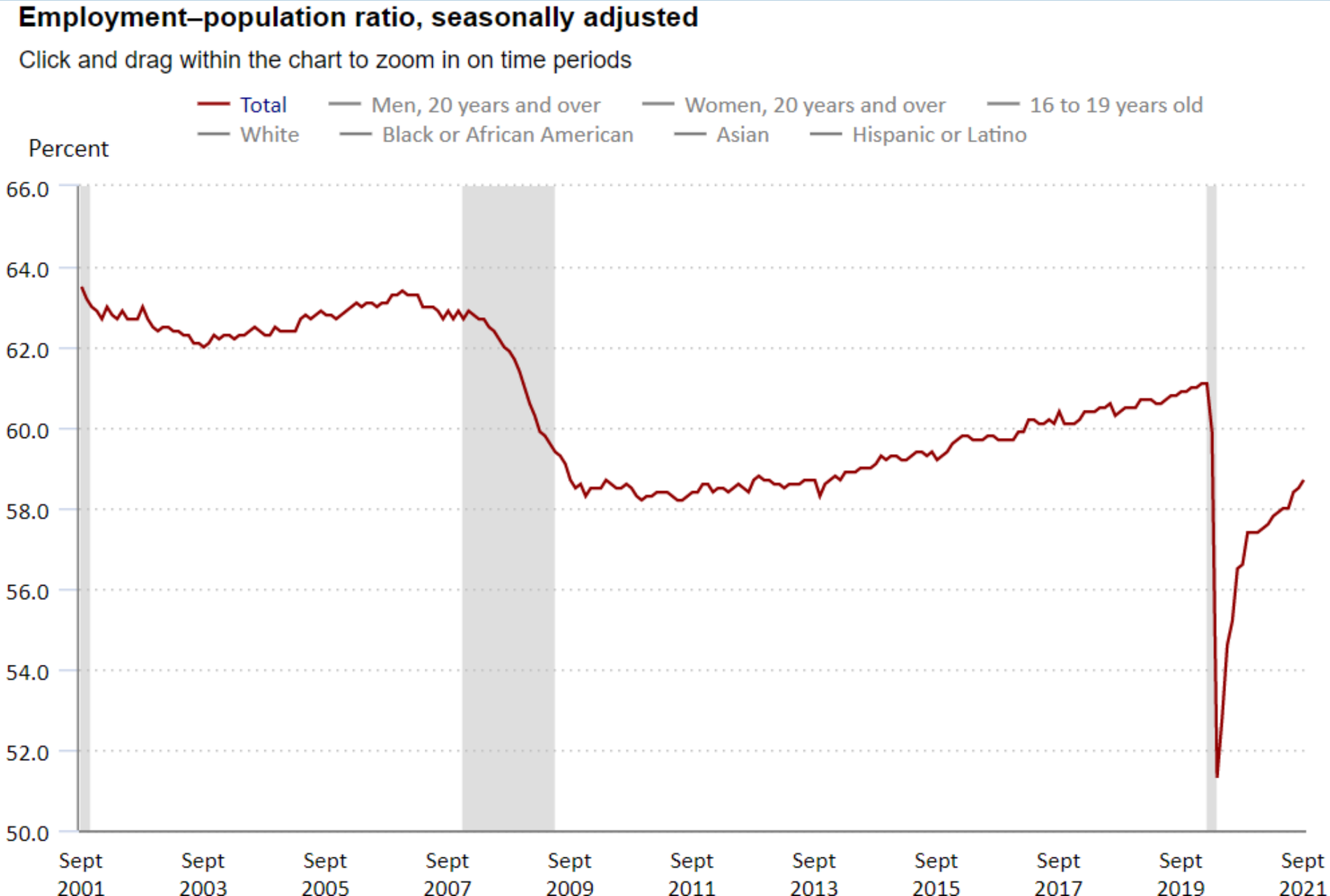
Labor market

Wow . . . . who would of thought

Unfilled job openings are not just at a record high !!!

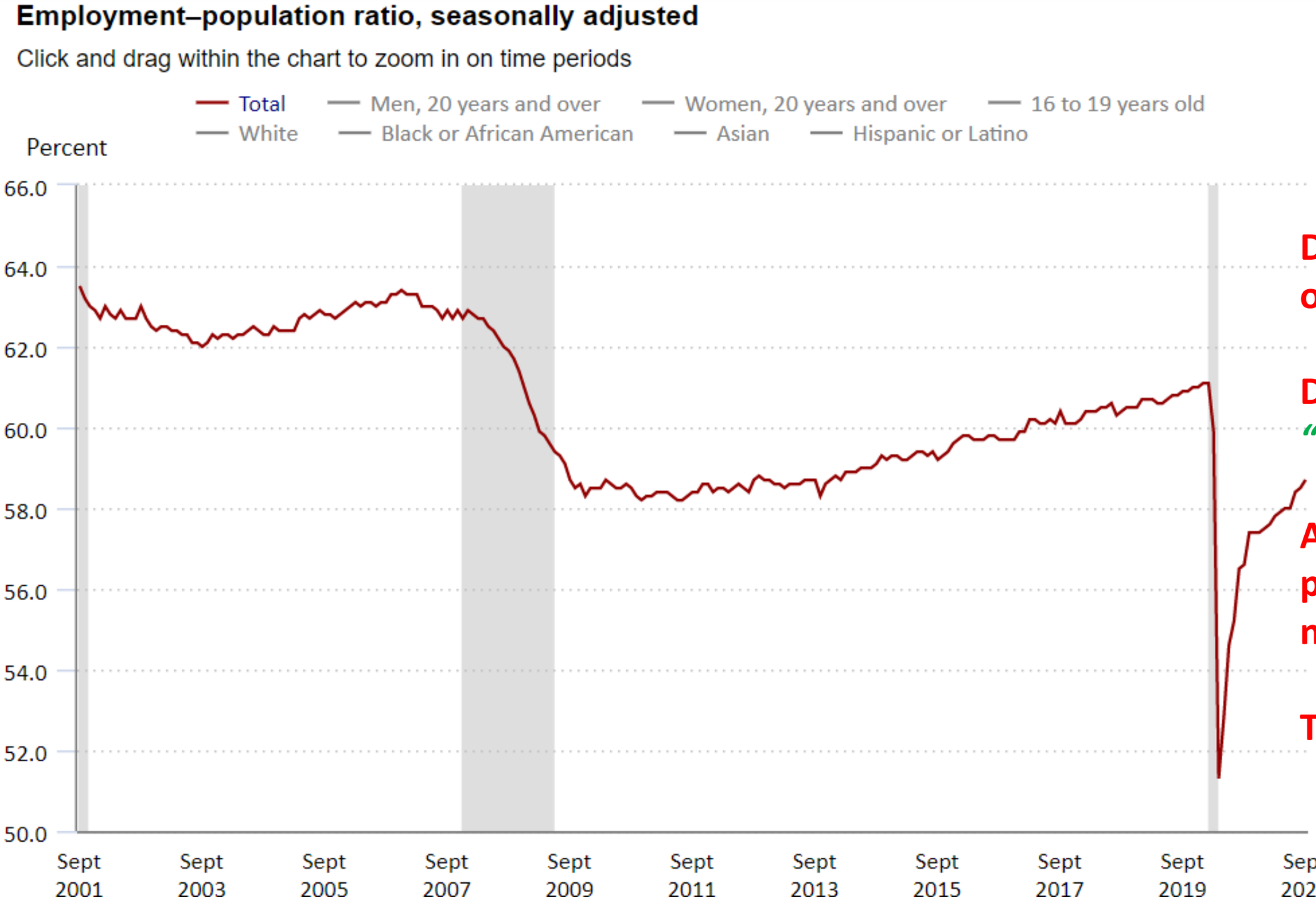


The labor force has disappeared



The labor force has disappeared

JULEX CAPITAL



Despite record unfilled job openings

Despite record numbers of *"help wanted"* signs

Almost 5% of the entire U.S. population has just quit and not gone back to work

This is mindboggling

Unspent excess savings

The elephant in the room

It’s big . . . It’s global

JULEX CAPITAL

Bloomberg Wealth

Economics

$2.7 Trillion in Crisis Savings Stay Hoarded by Wary Consumers

By Catherine Bosley and Michael Sasso

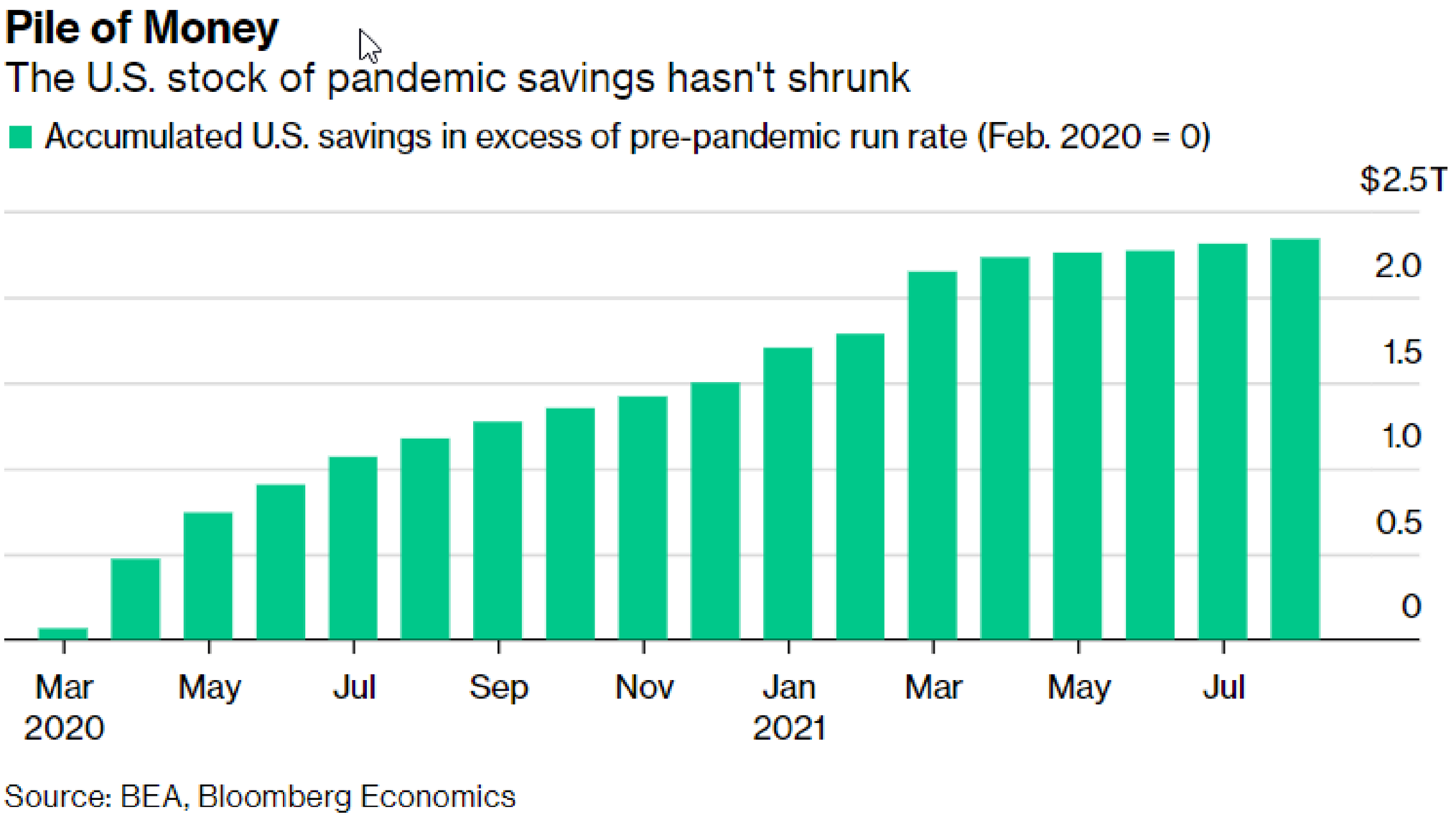
October 17, 2021, 1:00 AM PDT

- Europe, U.S. data suggest spending binge hasn’t materialized
- Demographics are a reason pile of savings isn’t getting spent

Present in every geography

Bloomberg Economics calculates the total of excess savings built up since the crisis began at about $2.3 trillion in the U.S. and almost 400 billion euros ($464 billion) in the euro zone.

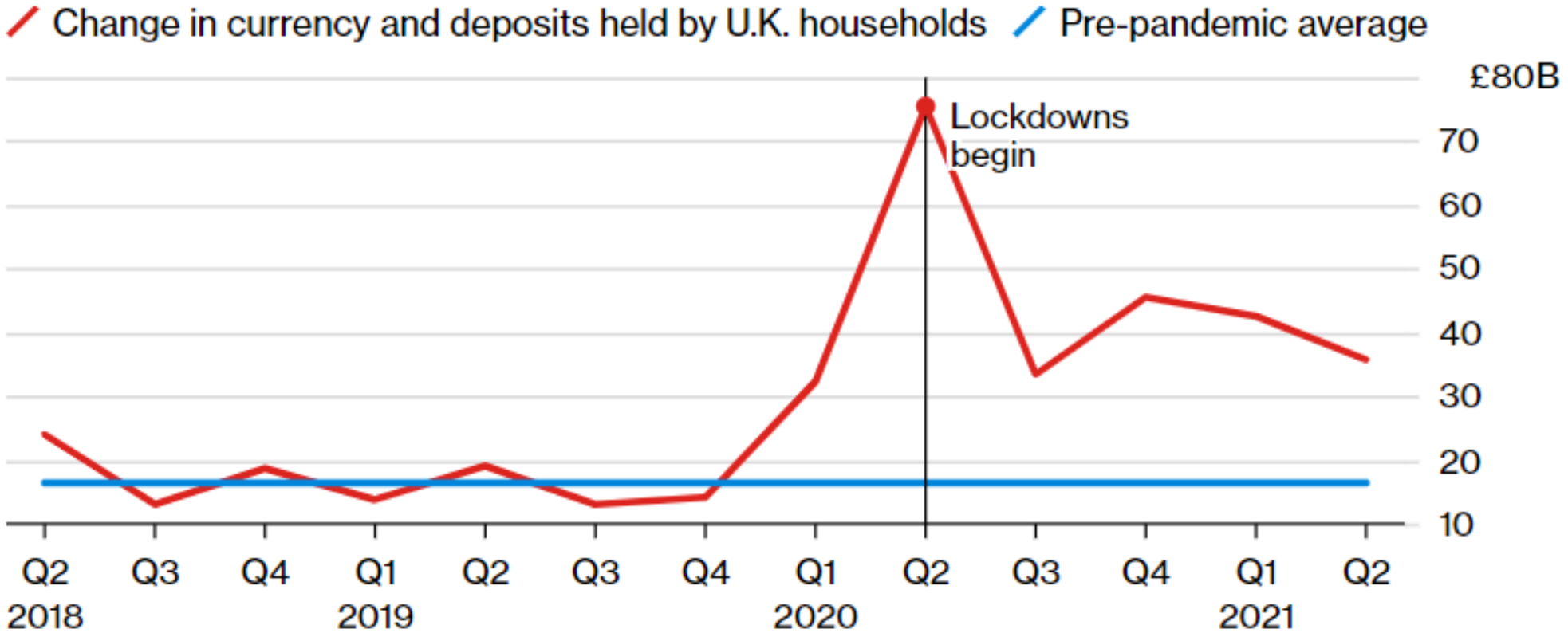
$2.3 trillion here in the U.S. - Ouch



Present in EVERY major economy

Piling Up

U.K. excess savings now total over $220 billion



Source: Bloomberg analysis of Office for National Statistics data
Note: Excess savings refer to amounts of saving over and above pre-pandemic levels

Inevitability of the tragic failure of the “60/40 portfolio”

Mr. Market has forgotten the distinction between “investment” and “speculation”

Valid source material to turn to

The Wealth Is In The Denominator

hussmanfunds.com/comment/mc211015

October 15, 2021

John P. Hussman, Ph.D.
President, Hussman Investment Trust

October 2021

Mr. Market goes to extremes - especially when the government intervenes

JULEX CAPITAL

As I've often noted, passive investing is always embraced at market extremes, because that's exactly the point when backward-looking returns are the most glorious. As a bubble progresses, investors become convinced that reliable valuation measures of the past have become obsolete, and that each recovery to new heights has vindicated stocks as a profitable and reliable medium for investment. As Graham & Dodd wrote in Security Analysis (1934), looking back on the bubble that ended in 1929:

"These statements sound innocent and plausible. Yet they concealed two theoretical weaknesses that could and did result in untold mischief. The first of these defects was that they abolished the fundamental distinctions between investment and speculation. The second was that they ignored the price of a stock in determining whether or not it was a desirable purchase. It was only necessary to buy 'good' stocks, regardless of price, and then to let nature take her upward course. The results of such a doctrine could not fail to be tragic."

All that's left . . . *"mindless speculation"* instead of *"considered investment"*

JULEX CAPITAL

Ultimately, valuations unfortunately become so extreme that negative future returns are essentially baked into the cake. At that point, the "mechanism" that supports the speculation is just speculative psychology itself. That's not enough to trigger an immediate market decline, but if (and when) enough investors become sufficiently risk-averse to consider the possibility of negative returns, Fed easing no longer "supports" the market because safe, zero-interest liquidity becomes a desirable asset rather than an "inferior" one. That's how stocks lost half their value in 2000-2002 and again in 2007-2009, despite persistent and aggressive Fed easing, all the way down.

What are the solutions?

There exist three “viable” solutions

Three “viable” solutions

- Wait it out
- Alts
- Tactical Asset Allocation

Wait it out

- Take temporary shelter in cash or ultra-short high-quality bonds

- BUT
  - This **is a bet** that the **stock-bear** and also the **bond-bear** will come along quickly and be over with pretty soon
  - Will these two bears arrive soon enough?
  - Do you have the patience . . . to just hang out in “cash”?

Wait it out

- If you take this path

- Julex has a great solution (in my mind)
- “Opportunistic TAA Yrs 0-5” portfolio

- But . . . it is a “holding vehicle” . . . waiting out the dual storms

Alts

- Recognize that almost all “Alts” are nothing more than misleading sales stories

- Retail alts . . . constitute the worst product development cycle in the entire history of our industry . . . the worst in 150 years

- Back in 1985
  - There were 380 hedge funds, 80 were worth investing in
  - You have a 1-in-5 chance of picking one that won’t hurt you

- Today
  - There are 3,800 hedge funds, but still only 80 worth investing in
  - You have a 1-in-50 chance of picking one that won’t hurt you

Alts

- Julex does not operate in the Alts space

- For my own clients
- I am pushing those with north of $10 million as far into alts as I can drive them

- But . . . . I'm extremely selective
- And . . . basing this push on 30 years of direct alts experience . . . most of which was institutional

Tactical Asset Allocation

- TAA is essentially the polar opposite of the “60/40 portfolio”

- TAA . . . effectively says
  - I will never adopt a fixed asset mix
  - Instead . . . I will continuously adapt and evolve
  - And those adaptation will always be big enough to deal with whatever comes along
  - And . . . I’ll always operate on a large enough playing field that I’m able to identify solutions (things that work)

Tactical Asset Allocation

- I am using and driving all of my clients (south of $10 million) as far into TAA as I can convince them

- Julex (in my mind) offers a brilliant set of TAA solutions
  - In their so-called Dynamic series
  - Which comes both domestic and international . . . so as to present a sufficiently large playing field from which to find winners

For more information contact

Jeff Megar, CFA
Email jeff.megar@julexcapital.com
Office 781-772-1378

Liam Flaherty
Email liam.flaherty@julexcapital.com
Office 781-489-5398

Investment scams past and present

Why this is important

Friday, October 29th at 11:00 a.m. EASTERN

Important Disclosures

All data and statistics were provided by Global Financial Data, Inc. (unless otherwise indicated in the exhibit)

This information in this presentation is for the purpose of information exchange. This is not a solicitation or offer to buy or sell any security. You must do your own due diligence and consult a professional investment advisor before making any investment decisions. The use of a proprietary technique, model or algorithm does not guarantee any specific or profitable results. Past performance is not indicative of future returns. The performance data presented are gross returns, unless otherwise noted.

The risk of loss in trading securities can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. All information posted is believed to come from reliable sources. We do not warrant the accuracy or completeness of information made available and therefore will not be liable for any losses incurred.

Some part of the investment performance shown is HYPOTHETICAL. It is based on the back tests of historical data. Hypothetical performance results have many inherent limitations, some of which are described below. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. In fact, there are frequently sharp differences between hypothetical performance results and the actual results subsequently achieved by any particular trading program.

One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. For example, the ability to withstand losses or adhere to a particular trading program in spite of trading losses are material points which can also adversely affect actual trading results. There are numerous other factors related to the markets in general or to the implementation of any specific trading program which cannot be fully accounted for in the presentation of hypothetical performance results and all of which can adversely affect actual trading results.

The composition of a benchmark index may not reflect the manner in which a Julex portfolio is constructed in relation to expected or achieved returns, investment holdings, portfolio guidelines, restrictions, sectors, correlations, concentrations, volatility, or tracking error targets, all of which are subject to change over time.

No representation or warranty is made to the reasonableness of the assumptions made or that all assumptions used to construct the performance provided have been stated or fully considered.