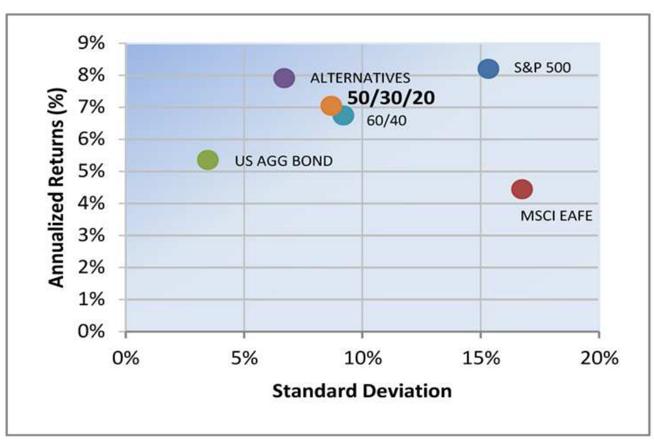
The New 60/40 Benchmark?

Investors have often embraced the 60/40 stock/bond benchmark as a good rule of thumb for building investment portfolios. Younger investors may adjust the stock portion up to 80% to reflect their longer-term holding period and older investors may adjust the stock portion down to 40% to reflect their reduced tolerance for volatility, but the majority of investors (ages 50 – 80) will likely utilize a version of the 60/40 benchmark to serve as an effective means of risk reduction and diversification. The basic allocation has seen several enhancements throughout time, such as the addition of international stocks and bonds, as well as other asset classes such as investment real estate and commodities. The historical investment performance looks very reasonable and it has served investors well in crises. Many have been able to enjoy the benefits of this allocation but the question is – are times changing?

Currently, the Barclays Aggregate Bond Index (an index often used to represent investment grade bonds traded in the U.S.) is yielding less than 2% and stock valuations are over 60% higher than historical averages, which puts pressure on the ability of a traditional 60/40 portfolio to generate large enough returns to support 4-5% annual withdrawals and still maintain principal. It is this very reason that alternative strategies have captured the attention of investors. Alternative strategies have many of the key characteristics that appeal to those who want diversification – lower volatility than equities, lower correlation to equities and bonds, and more stable return profiles. Consequently, there has been a growing movement to take some of the exposure in both equity and fixed income and place it in alternatives. This new portfolio mix is the 50/30/20 benchmark (50% stock / 30% bond / 20% alternatives).

The impact of adding a 20% allocation to alternative strategies can be seen below. While investors know that there is no magic bullet, the return to risk trade-off is compelling. In a low rate, low inflation, high stock price environment, there is good reason why this new mix is starting to become the standard.

1996 - 2015	Return	Standard Deviation
S&P 500	8.19%	15.33%
MSCI EAFE	4.42%	16.74%
US AGG BOND	5.34%	3.47%
ALTERNATIVES	7.90%	6.70%
60/40	**6.73%**	**9.21%**
50/30/20	**7.03%**	**8.69%**



The stock market has been quiet as of late, with a lack of market-moving news and historically low volatility. The year-to-date performance of several asset classes can be viewed in the chart below.

INDEX	JUL	AUG	SEP	QTR	YTD
S&P 500 (US Large Cap)	3.74%	0.13%	0.01%	3.88%	7.82%
Russell 2000 (US Small Cap)	5.87%	1.78%	1.07%	8.91%	11.53%
MSCI EAFE (Int'l Developed)	4.18%	0.39%	1.60%	6.26%	3.29%
MSCI EM (Emerging Markets)	5.37%	0.90%	2.52%	9.00%	17.26%
GSCI (Commodities)	-10.05%	2.01%	5.42%	-3.26%	5.50%
US Real Estate	4.26%	-3.76%	-1.84%	-1.51%	11.77%
Aggregate Bond	0.60%	-0.31%	0.12%	0.41%	5.89%

The S&P 500 has more than tripled from its 2009 low; however it seems that the scars of the 2008 financial crisis continue to loom in some investors' minds. Keep in mind that many factors influence market behavior. The most important is market valuations, but others include globalization, technology, demographics, the Fed and the economy, and unforeseen events, such as wars and natural disasters. Rather than react to the latest headlines, such as the 2016 elections, investors should remain focused on the investing principles that they can control:

- Cash-flow
- Diversification
- Costs
- Maintain a long-term view

TD Capital currently offers clients a unique mix of complementary investment strategies across equity, fixed income and alternative strategies. This investment approach seeks to deliver long-term risk-adjusted returns through differing economic and market cycles, while retaining focus on the preservation of capital. Call or come see us if you would like to discuss your specific investment strategy in more detail.