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The demise of the 60/40 portfolio

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For less aggressive investors who want less volatility, the traditional prescription used to be to add bonds to one's portfolio. This strategy worked very well for many decades, especially when bonds had higher yields and interest rates were on a downward trend. In the past, whenever stocks dropped, bonds usually would rally, which would offset the losses of the stock portion of the portfolio.

This year, not so much.

Through mid-June the S&P 500 is down more than 21% and the 20-year Treasury bond is down more than 25%. Bonds with shorter maturities were down less but still down nevertheless.

This is not surprising because when interest rates rise stocks tend to fall and bonds fall also. Many were worried about this scenario. In April 2021 Money magazine was doing a story on the traditional 60/40 portfolio and their reporter contacted me to get my thoughts for the article.

In the article the Money magazine reporter quoted me as saying "the 60/40 portfolio is antiquated. When bonds used to pay 6-8% interest and interest rates were falling, the 60/40 model worked great. Now the 40% which is supposed to reduce risk is fraught with interest rate risk and if interest rates rise, the bonds will go down in value. Why take that risk for such a small potential return?"

The question is what can investors own instead of bonds to reduce volatility?

I think that for the last several years many advisors just kept their portfolios business as usual with the traditional models while others simply rotated the bond portion of their portfolios to shorter maturities to mitigate, but not avoid, the inevitable declines that would occur with rising interest rates.

There are attractive alternative income investments like private credit funds and private preferred stocks which don't have the interest rates risk of fixed-income securities that not only provide attractive yields of 6%-7% but have not lost value this year like traditional bonds.

Bonds should be avoided in a rising interest-rate environment.

*Source Yahoo Finance

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