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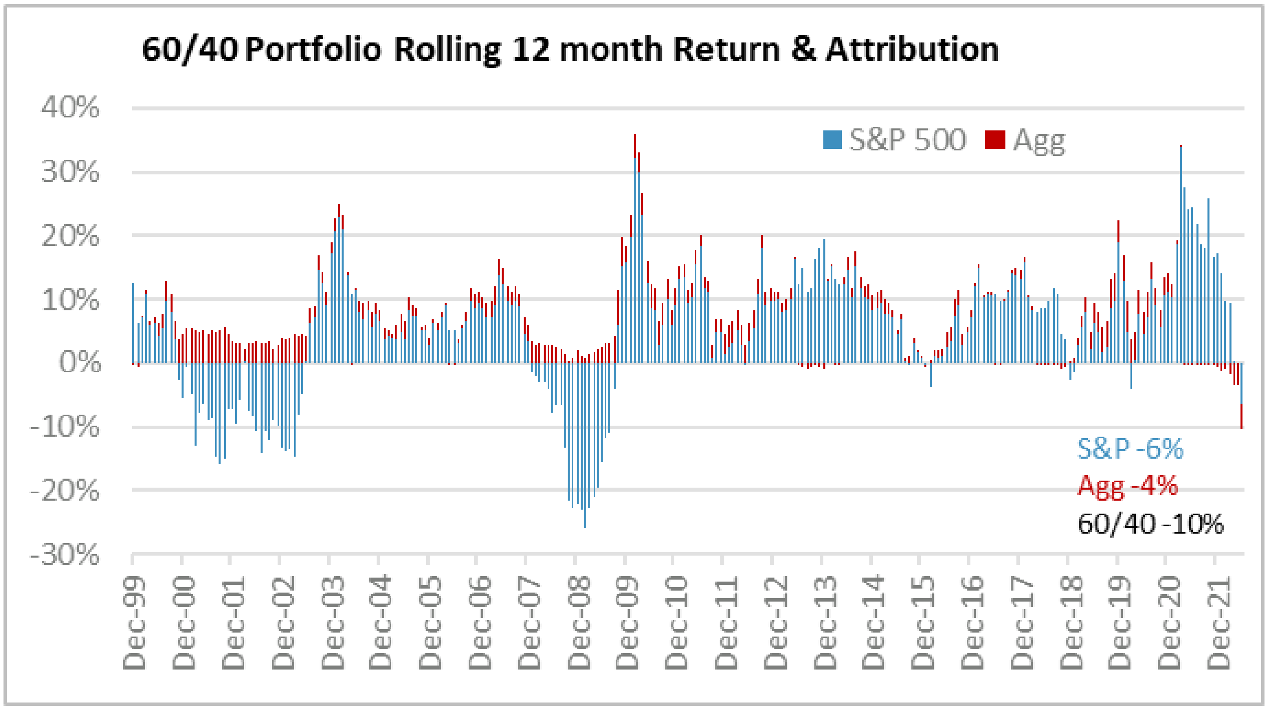
2022 Outlook Theme #2: 60/40 Knocked Off Balance

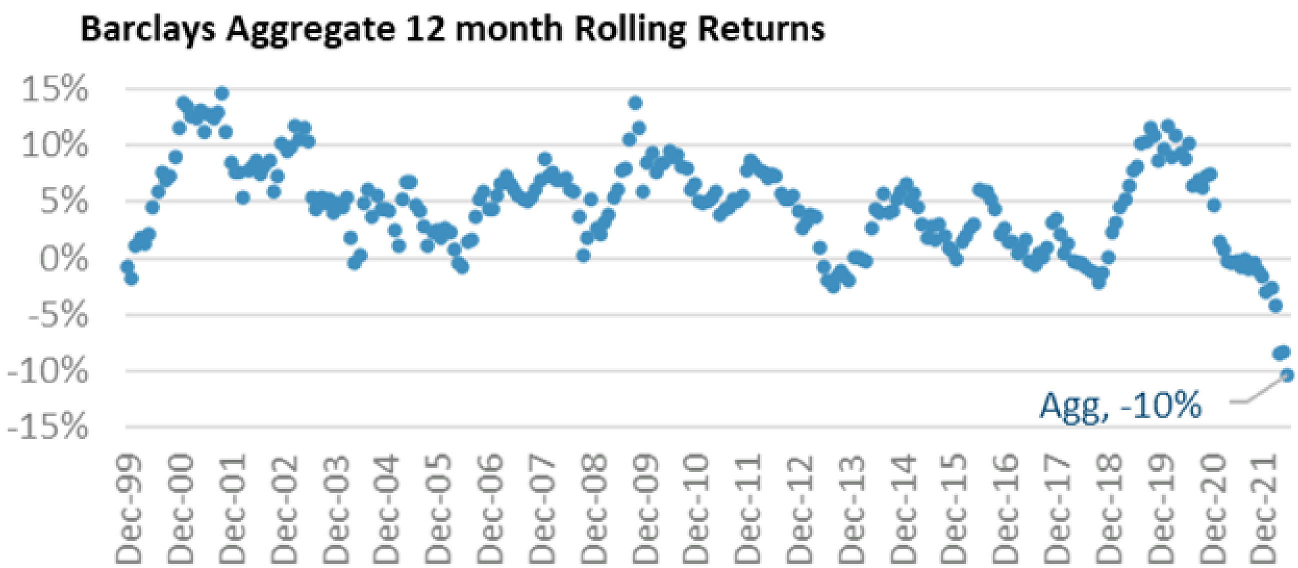
Benjamin B. Wallace, CFA – Portfolio Manager, Research Director

The typical balanced portfolio is 60% stocks and 40% bonds, known as “60/40”.



The chart to the left shows the rolling 12 month returns for 60/40, using S&P 500 and Barclays Aggregate total returns, as well as the contribution of stocks (S&P 500, in blue) and bonds (Barclays Aggregate, in red). For the period ending 6/30/22, trailing 12 month returns were -10%. Periods where returns were -10% or lower are infrequent, with only two groupings since 1999, concentrated in the 2001 dotcom crash and the 2008-2009 Global Financial Crisis (GFC). In other words, performance this poor for 60/40 is unusual.

The 2022 case, however, is unique. In 2001 and 2008, the Agg contribution was positive, shown by the positive red bars during those periods. This illustrates the diversification benefit of bonds delivering a positive return while stocks were declining. In 2022, the poor 60/40 performance is the result of both stocks and bonds declining, with both detracting from performance due to the impact of rising rates on both equity and fixed income prices.



The impact on fixed income is evident in the next chart, showing just the rolling returns for the Barclays Agg. The current 10% decline is the only time since 1999 they have been below -5%, let alone -10%. The rapid rise in interest rates, from a level that was too low, has been detrimental to returns across fixed income.

While the price declines have been unpleasant, the question going forward is whether the pullback provides investors enough compensation. In prior periods of 60/40 declines over 10%, the driver has been significant recessions. In this unique case of both stocks and bonds declining, is the situation going to be different? Thus far, the economy looks better off than those prior instances.

Because the Fed's policy (and inflation's impact) are widespread, both equity and fixed income have been impacted. However, just because the 60/40 is Knocked Off Balance, does not mean diversification should be abandoned.

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The information contained herein is based upon sources believed to be true and accurate. Sources include: *Factset Research Systems Inc.,* Bureau of Economic Analysis, Bureau of Labor Statistics, Congressional Budget Office, Board of Governors of Federal Reserve System, Fred: Federal Reserve Bank of St. Louis Economic Research, U.S. Department of the Treasury

-The Standard & Poor's 500 is a market capitalization weighted index of 500 widely held domestic stocks often used as a proxy for the U.S. stock market. The Standard & Poor's 400 is a market capitalization weighted index of 400 mid cap domestic stocks. The Standard & Poor's 600 is a market capitalization weighted index of 600 small cap domestic stocks.

-The NASDAQ Composite Index measures the performance of all issues listed in the NASDAQ stock market, except for rights, warrants, units, and convertible debentures.

-The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of 21 emerging markets. The MSCI All Country World Index is a free float adjusted market capitalization index designed to measure the performance of large and mid and cap stocks in 23 developed markets and 24 emerging markets. With over 2,800 constituents it represents over 85% of the global equity market.

-The Barlcays Aggregate Index represents the total return performance (price change and income) of the US bond market, including Government, Agency, Mortgage and Corporate debt.

-The BofA Merrill Lynch Investment Grade and High Yield Indices are compiled by Bank of America / Merrill Lynch from the TRACE bond pricing service and intended to represent the total return performance (price change and income) of investment grade and high yield bonds.

-The S&P/LSTA U.S. Leveraged Loan 100 is designed to reflect the largest facilities in the leveraged loan market. It mirrors the market-weighted performance of the largest institutional leveraged loans based upon market weightings, spreads and interest payments.

-The S&P Municipal Bond Index is a broad, comprehensive, market value-weighted index. The S&P Municipal Bond Index constituents undergo a monthly review and rebalancing, in order to ensure that the Index remains current, while avoiding excessive turnover. The Index is rules based, although the Index Committee reserves the right to exercise discretion, when necessary.

-The BofA Merrill Lynch US Emerging Markets External Sovereign Index tracks the performance of US dollar emerging markets sovereign debt publicly issued in the US and eurobond markets.

-The HFRI Fund of Funds index is compiled by the Hedge Funds Research Institute and is intended to represent the total return performance of the entire hedge fund universe.