Episode #252: Is the 60/40 Portfolio Dead?...Introducing the 60/20/20

Video Transcription

Hi, welcome to another episode of "Money Script Monday." My name is Brian Manderscheid.

Today, I want to talk about, is the 64/40 portfolio dead, and introduce a new 60/20 20. Now, we've got a lot of headlines lately about the 60/40 portfolio, and the question, is it dead?

Now today, what I want to do is look at the history of the 60/40 portfolio, look at how it's fared so far this year, and introduce the new 60/20/20 as a way for retirees to mitigate a lot of the risks they're facing these days, such as high inflation, running out of money, and all the volatility we're having in the stock market.

So first, we're going to talk about Modern Portfolio Theory, and this takes us back 70 years to the "Journal of Finance." Back in 1952, a gentleman by the name of Harry Markowitz posted this mathematical portfolio construction and essentially earned a Nobel Peace prize for his work.

Now, what Harry Markowitz was trying to do is create a mathematical approach to provide and maximize risk-based returns by using non-correlated diversified assets in a portfolio, essentially, 60% in stocks and 40% in bonds.

You see, stocks have more volatility, but they also offer more upside potential, whereas bonds have less volatility, but also less risk and upside. These two assets, working simultaneously, essentially is a way to maximize the returns in a portfolio based on a desired level of risk.

You see, bonds and stocks typically work inversely from one another. So, typically speaking when stocks or equities go up, bond values go down and vice versa.

Well, how has the 60/40 portfolio fared so far in the first half of 2022? Now, the results are in, and the 60/40 portfolio total return was negative 16.1%, which believe it or not, was the worst ever.

To put this in perspective, the second worst timeframe was back in 2008, which we know today as the Great Recession, the 60/40 portfolio was down negative 6.7%.

Now, if we break down these components individually, the S&P 500 was down the first half of 2022, negative 21% worst since 1970, and U.S. Treasuries were down 11%, the worst since 1973. U.S. Treasuries are typically considered a safe haven or risk-free asset, and you can see that they were down double digits worst in just about 50 years.

Now, you know, why had this portfolio not worked out as originally intended 70 years ago? Well, we've had a lot of things happen so far this year.

We've had the war in Europe. We've had quantitative tightening where the Fed has purposefully been increasing interest rates and shrinking their balance sheet has had the potential for a recession, and continued supply chain issues, all have an impact on the equity side.

Now, on the bond side, I want to explain a little bit about how bonds are priced. You see, bond prices work inversely to interest rate movement, meaning that when interest rates go up, the value of existing bonds goes down.

So, you see, all this happening simultaneously has created this environment where we've had the worst start ever in 2022 for the 60/40 portfolio.

Now, what we've been doing for many of our clients is moving over to the new 60/20/20. And I'll preface this, that we strongly believe in goal-based planning, evaluating our clients' risk tolerances, what their objectives are, and finding the optimal retirement portfolio construction for their unique situation.

So, I'm going to go over a general 60/20/20, some of our clients have greater longevity on their side and prefer more safety or more conservative.

They may put more into one section than the other based on their goals and their risk tolerance. The same thing for you when working with your advisor, we want to see if this makes sense, or if there are other alternatives to be better suited for your financial situation.

So, there are three steps to the 60/20/20. The first is to cut the bond weight from 40% down in half to 20% and consider using that 20% to fund an FIA or fixed indexed annuity.

Essentially, what we're doing is moving from one fixed-income vehicle, bonds, to another fixed-income vehicle, being an annuity. Additionally, the FIA is going to provide roughly bond-like returns, potentially higher, and potentially lower.

And since it's issued with an insurance company, it offers additional benefits that bonds can't provide, the first being longevity insurance. And what that does is it guarantees the income on this account for the rest of your life, potentially also for the life of your spouse, so that you won't run out of money for this portion of your portfolio.

Likewise, many annuities provide a level flat income. Annuities that we recommend for this 60/20/20 provide increasing income to provide an inflation hedge, so rather than level income, increasing income over your life to help hedge against inflation.

And lastly, principal protection, the benefit of this annuity is that the worst-case scenario is a 0% return, meaning that if the stock and bond

markets are down, rather than your account balance going down with it, it's just going to move sideways.

You're not going to get any growth, but you're not going to also experience any losses.

Additionally, not listed here, but we also are very fee sensitive and look for annuities that have low or, believe it or not, zero rider or base fees. So, that's step one.

Step two is using the reduced bond portion now 20% down from 40, we're going to use that for the first silo of your retirement phase. And we're going to spend that down over the first three to five years of your retirement.

For example, let's say you retire at 65, and you spend down your bond portion over five years from age 65 to 69.

What that allows you to do is take advantage of the 8% deferred income credits and maximize social security, taking it at 70 to get the highest amount of benefits. We call this strategy, a social security bridge.

Now, in step three, we're going to allow the equities to rebound. We've obviously had a big pullback in the stock market so far, 2022. Rather than selling at a loss or buying high and selling low, we're going to let the equities rebound.

If and when we experience gains, we're going to use those gains, sell at a high point to reallocate, and put money back into the bond portion.

You see, we're not going to take losses from the equity side. We're simply going to allow the equities to grow. That's going to be our growth bucket, and not take any distributions for at least three to five years.

So, to wrap things up and answer the question, is the 60/40 portfolio dead? We're not going to say yes, but we're going to say maybe. You see, over the last 40 years, we've had this declining interest rate

environment where bonds have done fairly well, whereas now over the last two years, we've had an increasing interest rate environment. And if this trend continues, the 60/20/20 should potentially outperform the 60/40.

Additionally, what I want to mention is we track annuity rates daily, and the rates that insurance companies are able to offer in form of growth and income payout rates are the highest they've been, and well over a decade.

So, if you're looking to make a move and reallocate from the 60/40 to the new 60/20/20, right now is the absolute great time to lock in the highest rates we've seen in quite some time on these annuities.

If you have any questions about the 60/20/20, please contact the advisor who sent you this video to get started.

Thank you very much. We'll see you next time.