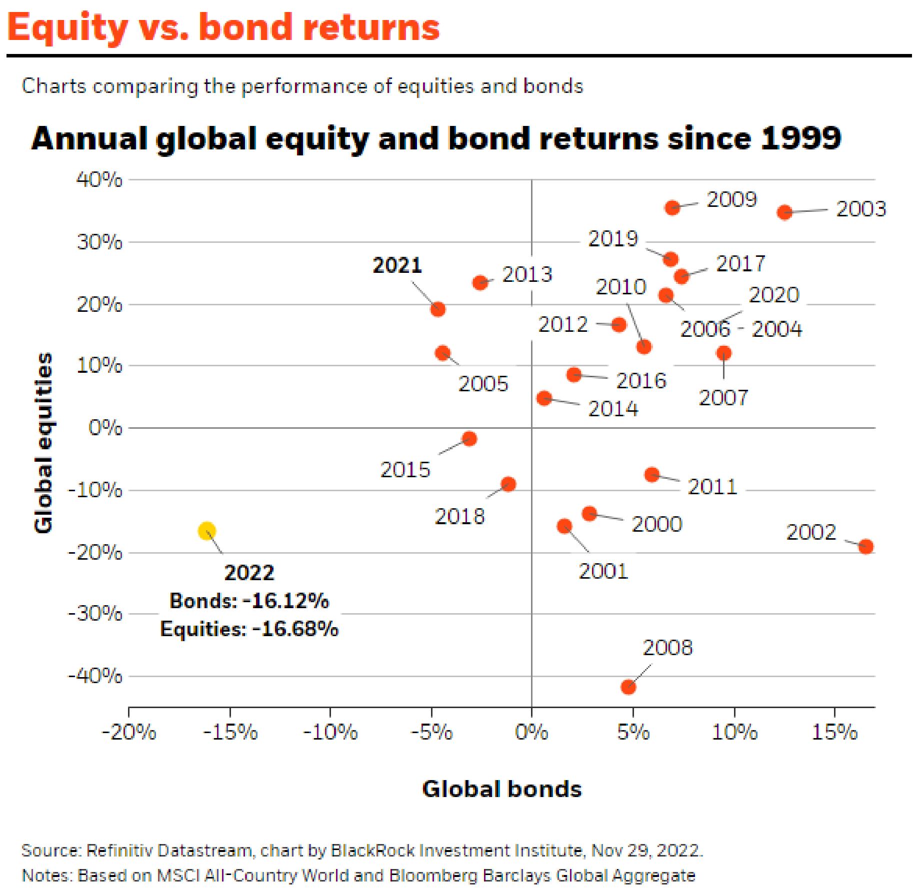
Losses to bond-equity portfolios in 2022 show traditional 60/40 model is outdated

- *Traditional 60/40 equity-bond portfolios have seen losses of 16% in 2022*
- *A whole portfolio perspective is critical, with asset allocation more important than ever*
- *'New regime' calls for more exposure to inflation-linked bonds, commodities, and infrastructure, as well as private markets, to ensure portfolio resiliency against inflation and economic headwinds*

XX November 2022 – Macroeconomic and market volatility have sent traditional 60/40 equity-bond portfolios plunging 16% this year. Persistently high inflation, together with concerns about poor economic growth, have seen investors grapple with the worst start to the year for both stocks and bonds in half a century, with global equities down 16.68% and global fixed income down 16.12%.[1]

High inflation has reignited debate about whether the 60/40 portfolio model is fit for purpose. Could it make a comeback or does the new market regime call for greater diversification? Amid seismic market shifts, we think investors faced with higher inflation, rising rates and weaker growth increasingly need to reassess their portfolios.

Graphic A Correlation of bond and equity returns



Vivek Paul, Head of Portfolio Research and UK Chief Investment Strategist for the BlackRock Investment Institute, commented: "During the 'Great Moderation', a period characterised by unusually steady growth and inflation, investors could rely on central banks riding to the rescue during growth crises – pushing down yields, and making bonds a fantastic hedge during equity drawdowns. This 'negative correlation' between bonds and equity was at the cornerstone of why a 60/40 portfolio used to make so much sense. In the new regime characterised by higher volatility, higher inflation and supply constraints, bonds won't work as well as a portfolio ballast compared to during the Great Moderation. Portfolios need to be built differently."

[1] BlackRock Investment Institute proprietary analysis, as of 29 November 2022.

Simona Paravani-Mellinghoff, Global Chief Investment Officer of BlackRock's Multi-Asset Strategies & Solutions (MASS) team, noted: "Given the current macroeconomic backdrop, we think it's important to reflect two key themes at a strategic asset allocation level. First, portfolio resiliency to inflation. In practice, this means more exposure than in the past to assets like inflation-linked bonds, commodities, and infrastructure. Second, the importance of private markets. Given the macroeconomic uncertainty, with potentially more headwinds to growth, private markets have become even more relevant as a way of accessing companies with innovative technologies in structural growth areas, like digitalisation and the energy transition."

Investors are changing their approach

We see investors, including asset managers, private and retail banks across Europe, as adapting the way they manage their portfolios as a result of the new macroenvironment.

1. **Increased adoption of indexing:** The growth of index investing in EMEA has continued to progress, with a compound annual growth rate (CAGR) of 18.1% over the last 10 years[2].

2. **Commitment to sustainable investing:** European investors continue to understand that climate risk is investment risk. A recent survey of 170 investors revealed that 63% have not changed their appetite to invest sustainably, despite the more complex market environment of 2022. Twenty-three percent affirmed they are more likely to invest into sustainable strategies as a result[3] .

Additionally, investors are having to increasingly expand the range of asset classes held in their portfolios over the past five years to continuously achieve their investment objectives.[4]

Number of products required to express investment views

	Equity	Fixed Income	Multi-Asset	Alternatives	Total
2018	8	5	2	3	18
2019	9	5	1	1	16
2020	9	5	1	1	16
2021	11	6	3	3	23
2022	11	7	2	5	25

Ursula Marchioni, Head of BlackRock Portfolio Consulting EMEA, notes: "We see the evolution in index penetration and the increase in the number of building blocks, as indicative of the more volatile and uncertain macro and market regime, and the need for investors to attain more control over portfolio outcomes. We see the evolution of implementation choices as reflective of investors' desire to manage the downside better but also capture new opportunities as market dislocations occur, in an overall environment that requires them to be increasingly more dynamic and selective."

"Investors need to take a whole portfolio approach and consider their portfolio's different building blocks; how they interact, complement and potentially neutralize each other. This is particularly critical in an environment driven by macro volatility, where the behavior of rates or inflation exposures will be huge determinants of overall portfolio outcomes."

END

Editor's Notes

- The Great Moderation, from the mid-1980s until 2019 before the Covid-19 pandemic struck, was a remarkable period of stability of both growth and inflation. We were in a demand-driven economy with steadily growing supply. Borrowing binges drove

[2] ETFs and index mutual funds only. ETF data from BlackRock Global Business Intelligence as of September 2022 – active ETFs excluded. IMF data from Broadridge as of September 2022.

[3] BlackRock Portfolio Consulting EMEA *'Sustainable transition: pushing ahead, with more complexity'*. Please note that results derived were based on the sample BlackRock Portfolio Consulting collected and, therefore, should not be seen as fully representative of the EMEA Wealth industry. Sample biases will be linked to the specific client choices as well as the sample size of portfolios and surveys collected in each region.

[4] Source: BlackRock Portfolio Consulting EMEA, BlackRock Aladdin. As of 31 December 2021 for portfolios collected between January 2021 and December 2021. As of 30 June 2022 for portfolios collected between January 2022 and June 2022. Currency: EUR. For Illustrative purposes only.

overheating, while collapsing spending drove recessions. Central banks could mitigate both by either raising or cutting rates. That period has ended – we are now in a new regime of heightened macro and market volatility.
- The new regime is shaped by supply constraints that are set to stay – largely driven by an ongoing labour shortage, persistent geopolitical fragmentation, and the transition to net-zero carbon emissions reshaping energy demand and supply over time.

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