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THE INVESTMENT EXPERTS

Is The 60/40 Portfolio Strategy Still Effective?

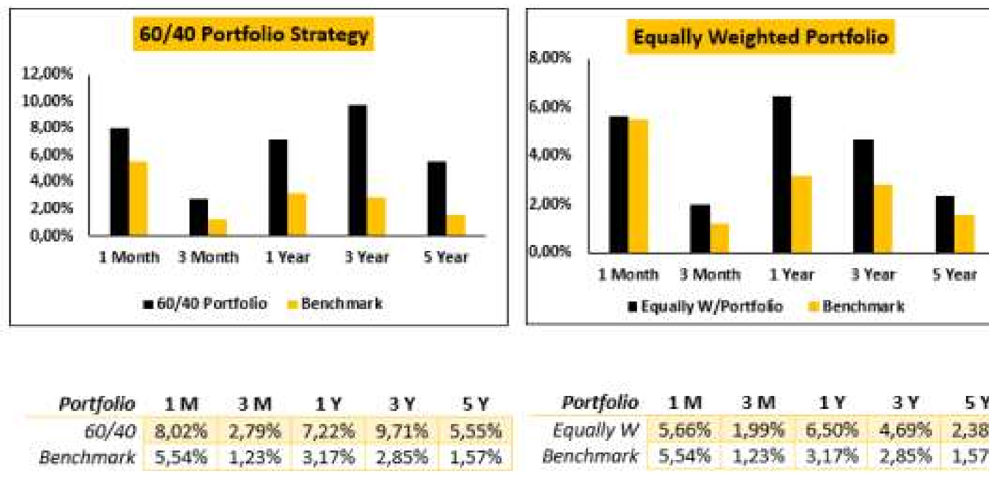
The current investment environment that we are dealing with is likely the most difficult in recent memory because of a myriad of unfavourable circumstances that have, in the end, led to significant losses for the majority of portfolios. These losses have led most investors to now question some portfolio strategies employed by fund managers to protect capital and spur growth. Such heuristics strategies include the famous 60/40 approach, naïve diversification, which entails equally weighting each asset class to avoid regret bias, the “120 minus your age” rule, the endowment model, and risk parity.

Given the current financial environment we are in, we have chosen to focus our analysis on the 60/40 and equally weighted portfolio strategies to see which one provides a greater return.

The 60/40 technique allocates the investment into 40% fixed bonds and 60% stocks. In this approach, the fixed income allocation is seen as providing the portfolio with benefits related to risk reduction while the equities allocation is seen as providing a platform for long-term growth. However, an ideal diversified portfolio is created if the stock and bond allocations are themselves varied.

On the other hand, an equally weighted portfolio distributes investment among various asset classes, including cash, bonds, real estate, and equities. In this simplest asset allocation method, risk is evenly distributed across all asset classes.

We compared these two techniques using performance figures of unit trusts with a 10-year track record and a sizeable market capitalisation of over R10 billion. The graphs below depict the performance of the two strategies as of 17 August 2022:



Portfolio	1 M	3 M	1 Y	3 Y	5 Y
60/40	8,02%	2,79%	7,22%	9,71%	5,55%
Benchmark	5,54%	1,23%	3,17%	2,85%	1,57%

Portfolio	1 M	3 M	1 Y	3 Y	5 Y
Equally W	5,66%	1,99%	6,50%	4,69%	2,38%
Benchmark	5,54%	1,23%	3,17%	2,85%	1,57%

As can be seen from the figures above, the 60/40 method outperformed the equally weighted portfolio by an average of more than 170 basis points. This shows that, despite the substantial risk involved, a high equity allocation is vital for a portfolio. Additionally, the equally weighted portfolio was significantly impacted by the property asset class, which has underperformed in the medium to long term, while the performance of the 60/40 strategy, which is intended to provide equity-like returns with bond-like volatility, was stellar over a range of time from one month to five years.

What therefore can we conclude from this brief comparison of the two approaches? Should we continue to use the 60/40 strategy to increase returns in these challenging times, or should we change our attention to an equally weighted approach among other investment ways to weather the storm?

To answer these questions, there is no one-size-fits-all method to investing, so to address these concerns, we advise staying with an approach or program that takes into account your financial goals, liquidity requirements, time horizon, risk tolerance, and other special needs you may have. In addition, because markets are cyclical, success depends on maintaining discipline within a certain investing program or approach.

Last but not least, to weather any investment tide of any magnitude, effective investment governance is essential. This includes clearly defined long- and short-term investment objectives, distribution of decision rights and responsibilities, development of an investment policy statement, and the investment program's strategic asset allocation.

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