Origo Insights – All you need for Christmas is a 60/40 portfolio?

In an apparent sign that the financial sector is giving up on asset allocation – at least the active kind – a debate has started on some of the major US financial websites over the merits of a 60/40 portfolio, ie. a portfolio that consists of 60% stocks and 40% bonds.

Good news on the vaccine front (technical)

As usual, when such a discussion is taking place between non-practitioners a lot of practical stuff is left out. The unspoken is often very interesting. How often should the portfolio be rebalanced? What about exchange rate effects? And what about the fees charged by portfolio managers? But let us not be held back by such trivia.

Many independent advisors have subscribed to the view that a "natural" position for the average smaller investor is to hold 60% US stocks and 40% bonds. As the investor gets older, the shareholdings could be brought down, reflecting that older investors have little time left to recoup losses from such a stable strategy.

A very relevant question is what a 60/40 should invest in. We like things really simple, so we prefer to look at only two ETFs, when possible. In that way, a balanced portfolio cannot be made any simpler.

Diving into the practical details

That the merit of a passive 60/40 portfolio comes up is obvious. A simple US portfolio invested 60/40 in the two ETFs SPY and BONDS (??) has returned xx percent in 2020, measured in USD. Spanning a year with pandemic meltdown, through the swift global agreements to support economic growth to the good news of not one but several vaccines coming, this result appears acceptable.

The merits of such a portfolio used on a global portfolio of stocks and bonds or a similar European portfolio are not that bad either. A global portfolio consisting of the IBCH and XBAE ETFs has yielded yy per cent this year, measured in EUR. A similar European portfolio investing XXXXX and YYYYY has returned zz% in EUR to date.

We have hedged currency risks, as we believe that managing currency swings is essentially only for full-time investors. Still, many investors would have been happier this year if they had followed such a simple strategy.

However, before thinking that the solution to everything is a stable asset allocation, it might be an idea to see what happened in 2020.

The year started on a high note with both stocks and bonds soaring (we chronicled in January that this was a major signal of danger ahead). In late February, we got the CoVId19 stock market massacre. At the same time, long bonds soared, softening the blow to portfolios. At the end of March, the world had agreed on a joint plan to keep the economies going. Stock markets soared, while bonds did not really go anywhere. Bond market players were obviously not THAT optimistic that the economies would come back quickly. Show me the money, as they say in Missouri.

Finally, in late November as the vaccine announcements came rolling in, stock markets again reacted positively, while bonds now began to appear mildly convinced that economic growth could possibly return in 2021.

This development over the year undermines all those who claim that due to very low bond yields there is no alternative to stocks. This year, long bonds have been one of the best performing asset classes, even if they started the year with already low yields.

The score

As the story of the 60/40 portfolios demonstrate, bonds have a had a clearly stabilising effect on portfolios in 2020. There is no reason to expect this should not continue going forward. Claims that "there is no alternative to investments in stocks" are have no merit. In 2020, the "stable portfolio" of 60/40 did well exactly because of the diversifying effect of long-dated bonds.

When trying to evaluate if the 60/40 portfolio yielded "enough", it is worthwhile taking a look at Origo's recommendations to professional investors. On 21 February we called that investors should have "zero, silch, nada" invested in the stock markets. Exactly a month later we made the opposite call: go back to the asset allocation held before our last call.

Since then we have largely held the portfolio weights unchanged. A 60/40 portfolio that executed these two calls returned the following to date (24 November 2020):

Region	Currency	Passive portfolio	Active portfolio
USA	USD		
Europe	EUR hedged		
Global	EUR hedged		

There are two conclusions to this little story

A: bonds are an important element in portfolio building, even if yields are low and
B: You only need to get a few calls right every year.

From a personal point of view, we can only complain that we do not exactly know the days when you need to reshuffle the portfolios. Having this information would free us of going to work most of the year.

But what do the proponents of the passive 60/40 portfolio do with their time? They only need to go to work when new money has arrived or what?

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