RBC Global Asset Management

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A new era for balanced investing

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The traditional balanced portfolio of 60% stocks and 40% bonds has long been viewed as a successful investment strategy. However, we often see articles questioning whether this strategy can continue to deliver on its promise of stable and consistent results. Many of these doubts seem to surface during periods of volatility or when markets undergo rapid change as they did in 2022 when central banks aggressively hiked interest rates. While balanced funds were not immune to the volatility that came as markets adjusted to higher interest rates over the past two years, we believe that the case for the 60/40 balanced portfolio, and balanced investing in general, remains compelling.

A long history of providing stability

The success of the 60/40 portfolio is centered on the belief that diversifying one's holdings across multiple asset classes in a single portfolio can provide more stable returns than investing in any one asset class. That is because the performance of different asset classes – such as cash, bonds and stocks – tends to rise and fall at different times with changes in a variety of factors such as economic growth, inflation expectations, corporate earnings and interest rates (Exhibit 1). This can lead to a wide range of outcomes from one year to the next. Understanding the dynamics of how asset classes behave in relation to each other is fundamental to building investment portfolios that can deliver long-term results.

The diversified approach of the balanced strategy has worked well over time, earning an average return of 8.4%[1] over the past 40 years. We believe there are three key developments that have contributed to this success. First, robust bond returns have been fueled by a 40-year bull market which saw the yield on the 10-year U.S. Treasury bond fall from peak levels of 16% in the 1980s to just over 1% by the end of 2021. Second, extraordinary monetary policy support following the 2008-2009 financial crisis drove strong stock market returns through the subsequent decade and beyond. Lastly, stocks and bonds have largely exhibited negative correlation, which happens when two factors or variables consistently move in opposite directions to one another – when stock prices fall, bond prices rise and vice versa. This inverse relationship

[1] RBC Global Asset Management, *Global Investment Outlook – Summer 2024*, https://www.rbcgam.com/en/ca/insights/global-investment-outlook

Exhibit 1: The benefit of diversification

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
EM Equities 15.6%	US Equities 41.6%	US Equities 24.4%	US Equities 20.8%	CDN Equities 21.1%	EM Equities 28.3%	US Equities 3.8%	US Equities 25.1%	EM Equities 16.6%	US Equities 27.6%	Cash 1.7%	US Equities 22.9%
US HY Bonds 15.4%	INTL Equities 31.0%	Balanced Portfolio 11.9%	INTL Equities 19.0%	US HY Bonds 14.3%	INTL Equities 16.8%	Global bonds 1.9%	CDN Equities 22.9%	US Equities 16.1%	CDN Equities 25.1%	CDN Equities -5.8%	INTL Equities 15.1%
INTL Equities 14.7%	Balanced Portfolio 16.8%	CDN Equities 10.6%	Balanced Portfolio 8.2%	US Equities 8.6%	US Equities 14.1%	CDN Bonds 1.4%	INTL Equities 16.5%	Balanced Portfolio 10.0%	Balanced Portfolio 11.2%	INTL Equities -8.2%	Balanced Portfolio 12.8%
US Equities 13.1%	CDN Equities 13.0%	Global Bonds 9.4%	CDN Bonds 3.5%	EM Equities 7.3%	Balanced Portfolio 9.8%	Cash 1.3%	Balanced Portfolio 15.5%	CDN Bonds 8.7%	INTL Equities 10.8%	Balanced Portfolio -10.3%	US HY Bonds 12.5%
Balanced Portfolio 8.7%	US HY Bonds 7.1%	CDN Bonds 8.8%	EM Equities 2.0%	Balanced Portfolio 6.0%	CDN Equities 9.1%	Balanced Portfolio -1.1%	US HY Bonds 14.0%	INTL Equities 6.4%	US HY Bonds 4.6%	US HY Bonds -11.2%	CDN Equities 11.8%
CDN Equities 7.2%	EM Equities 3.9%	EM Equities 6.6%	Global Bonds 1.9%	Global Bonds 3.5%	US HY Bonds 6.4%	US HY Bonds -2.9%	EM Equities 12.9%	Global bonds 6.0%	Cash 0.1%	CDN Bonds -11.7%	EM Equities 6.9%
CDN Equities 5.3%	Global Bonds 1.0%	US HY Bonds 4.3%	Cash 0.6%	CDN Bonds 1.7%	CDN Bonds 2.5%	INTL Equities -6.0%	CDN Bonds 6.9%	CDN Equities 5.6%	Global bonds -2.3%	US Equities -12.2%	CDN Bonds 6.7%
CDN Bonds 3.6%	Cash 1.0%	INTL Equities 3.7%	US HY Bonds -2.7%	Cash 0.5%	Global Bonds 1.8%	EM Equities -6.9%	Global bonds 6.8%	US HY Bonds 5.1%	CDN Bonds -2.5%	Global Bonds -13.5%	Global Bonds 5.6%
Cash 0.9%	CDN Bonds -1.2%	Cash 0.9%	CDN Equities -8.3%	INTL Equities -2.5%	Cash 0.6%	CDN Equities -8.9%	Cash 1.7%	Cash 0.6%	EM Equities -3.1%	EM Equities -14.3%	Cash 4.8%

Note: Calendar year returns as of July 31, 2024. Cash: FTSE Canada 30 Day TBill Index, Global Bonds: FTSE World Government Bond Index (CAD Hedged), CDN Bonds: FTSE Canada Universe Bond Index, US HY Bonds: ICE BofA US High Yield BB-B Index (CAD Hedged), CDN Equities: S&P/TSX Composite Index, US Equities: S&P 500 Index, INTL Equities: MSCI EAFE Index, EM Equities: MSCI Emerging Markets Index. Balanced Portfolio represented by 2% Cash, 38% Fixed Income (Canadian bonds), 15% Canadian Equities, 25% U.S. Equities, 15% International Equities and 5% Emerging Market Equities. All returns are total returns in Canadian dollars. An investment cannot be made directly into an index. The above does not reflect transaction costs, investment management fees or taxes. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results. Source: RBC GAM

meant that bonds have frequently acted as a dependable ballast during periods of equity market volatility, giving balanced investors a more stable investment experience. This is a key reason why holding a well-diversified investment, like a 60/40 balanced portfolio, has been an important strategy for investors.

Are balanced portfolios now out of balance?

However, a major shift unfolded for markets at the start of 2022. To combat soaring inflation, global central banks began their most aggressive interest rate hiking cycle in decades. This rapid adjustment in interest rates led to a massive repricing across bond markets, as rising interest rates caused bond prices to fall from their prior peaks. At the same time, stock markets tumbled from all-time highs amid recessionary fears stemming from the impact that higher inflation and interest rates could have on economic growth.

The negative performance of both asset classes in 2022 resulted in a challenging period of returns for balanced portfolios. Despite a strong recovery in the 18 months that followed, the negative performance of both stocks and bonds in 2022 led some to question the validity of a diversified approach and whether the positive correlation marked the end of the 60/40 balanced portfolio.

In our view, the case for balanced investing remains compelling

We agree that the investing landscape has changed dramatically over a short period of time, particularly in fixed income. But the assertion that the 60/40 balanced fund is dead because it didn't pay off in 2022 misses the point with respect to the long-term benefits of diversification. While correlations and negative performance by both stocks and bonds over the short term are important considerations for a diversified portfolio, there are several reasons why we believe that the case for balanced funds remains compelling.

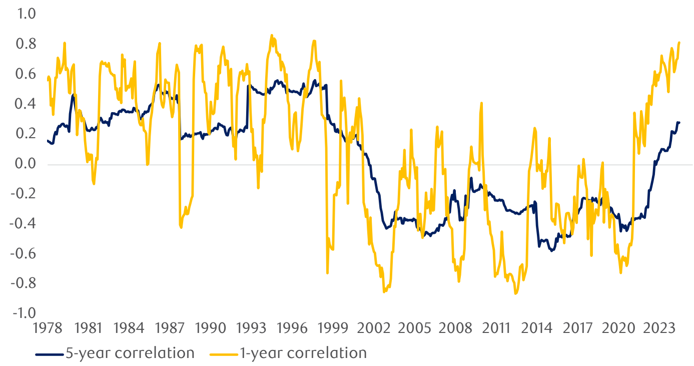
1 Positive correlation can also mean positive returns

Basic investment theory teaches us that diversification is best achieved by combining assets that are negatively correlated, where investment returns move in opposite directions. However, in practice, correlation and the degree to which asset classes rise and fall can vary considerably, especially over the short term (Exhibit 2). Rarely are investors concerned with positive correlation when stocks and bonds are both rising together, which happens fairly frequently. But it is during periods of equity market stress that investors want that negative relationship between bonds and stocks to hold (Exhibit 3).

2 Bonds can offset equity market volatility even when returns are negative

Looking at the last 26 bear markets since the early 1880s, bonds have largely been negatively correlated to stocks, providing a positive return to offset equity market drawdowns almost 90% of the time. But there are three periods where that wasn't the case, including 2022. During those bear markets, stocks and bonds were positively correlated and both generated negative returns. But it is worth noting that while both asset classes fell in tandem, bonds fell much less. The negative returns by stocks during those three periods were, on average, five times greater than those exhibited by bonds. While bear markets are never easy, the analysis shows that bonds are still a valuable diversifier during equity market volatility, even in periods of positive correlation, and that bonds provide a cushion to balanced portfolios when investors need it most.

Exhibit 2: U.S. stock-bond correlation (1978 – 2024)



Note: From January 1, 1978 to July 15, 2024. Monthly 5-year and 1-year rolling correlations of S&P 500 Index (USD) and Bloomberg US Treasury Index (USD).
Source: RBC GAM, Bloomberg

Exhibit 3: Stock and bond performance during equity bear markets

		Total return	
Start of Bear market	End of Bear market	Equities	Bonds
Jun-1881	Jun-1885	Negative	Positive
May-1887	Dec-1890	Negative	Positive
Oct-1892	Aug-1893	Negative	Positive
Sept-1895	Aug-1896	Negative	Positive
Sep-1902	Oct-1903	Negative	Positive
Sep-1906	Nov-1907	Negative	Positive
Dec-1909	Dec-1914	Negative	Positive
Nov-1916	Dec-1917	Negative	Positive
July 1919	Aug-1921	Negative	Positive
Sep-1929	Jun-1932	Negative	Positive
Feb-1934	Mar-1935	Negative	Positive
Mar-1937	Mar-1938	Negative	Positive
Nov-1938	Apr-1939	Negative	Positive
Oct-1939	Apr-1942	Negative	Positive
May-1946	Jun-1949	Negative	Positive
Aug-1956	Oct-1957	Negative	Negative
Dec-1961	Jun-1962	Negative	Positive
Feb-1966	Oct-1966	Negative	Positive
Nov-1968	May-1970	Negative	Negative
Jan-1973	Oct-1974	Negative	Positive
Nov-1980	Aug-1982	Negative	Positive
Aug-1987	Dec-1987	Negative	Positive
Mar-2000	Oct-2002	Negative	Positive
Oct-2007	Mar-2009	Negative	Positive
Feb-2020	Mar-2020	Negative	Positive
Jan-2022	Sep-2022	Negative	Negative

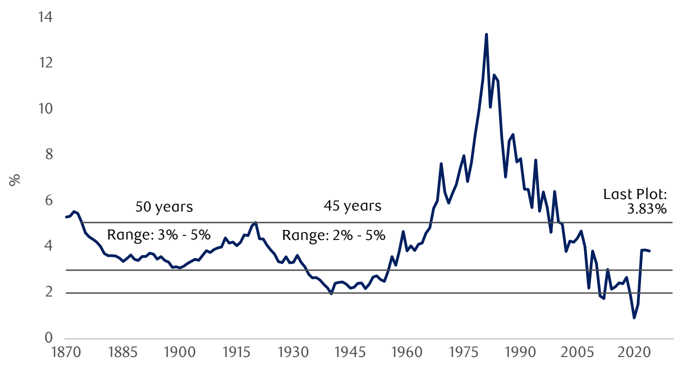
Note: Return as of December 31, 2023 for a 60/40 balanced portfolio comprised of 60% stocks and 40% bonds. Bonds = U.S.10-year Treasury bond, Stocks = S&P 500. Returns in USD and do not include fees or taxes.
Source: RBC GAM

3 We expect bonds to resume their role as diversifiers going forward

After years of below average yields, we are no longer seeing the valuation risk in bonds that existed prior to 2022, and yields are now well within their normal range of the past 150 years (Exhibit 4). Furthermore, we have growing confidence that inflation pressures will continue to subside and that there is less of a need for highly restrictive monetary policy, which should keep bond yields within the historical range. Inflation's decline slowed briefly in the spring and early summer of this year, but more recent data indicates that inflation is headed in the right direction. This has important implications for bond markets and we believe that the prospective returns for fixed income are reasonably attractive.

Bonds are a good source of interest income, as well as capital gains should yields decline. At current levels, potential price gains could be even more pronounced if the economy stumbles and prompts a bid for safe-haven assets. More importantly, we believe that this reset in fixed income valuations means that bonds can resume their role as a dependable ballast against equity market volatility in balanced portfolios. We saw signs of this during the stock market selloff in early August when bond yields fell/bond prices rose and fixed income provided the type of defense that investors had grown accustomed to in previous decades.

Exhibit 4: U.S. 10-year bond yield



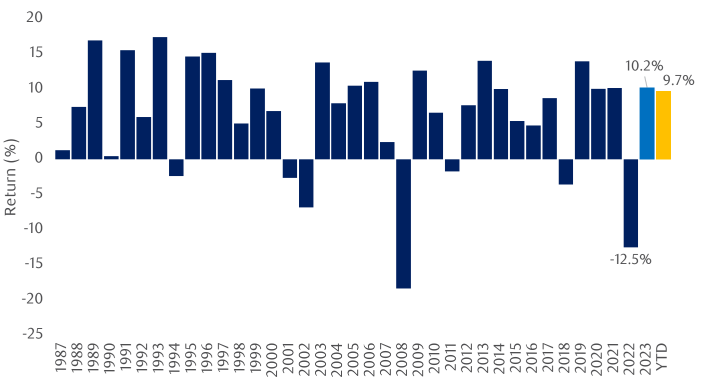
Note: As of August 6, 2024. Source: RBC GAM

4 Good years tend to follow bad years

Historically, periods of negative performance for a balanced portfolio have rarely persisted beyond one year. In fact, they tend to be followed by stronger returns in the following years. If investors had become unsettled by the volatility in markets in 2022 and sold their investments, they would have missed out on some substantial returns in 2023 and the first half of 2024 (Exhibit 5). These strong returns serve as a reminder that staying invested and not trying to time the market are key investing principles.

Exhibit 5: RBC Select Balanced Portfolio

Calendar-year returns

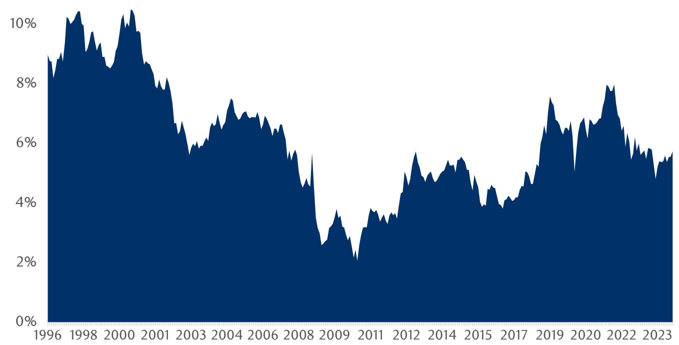


Note: Data as of July 31, 2024. Series A performance shown. See standard performance data at the end of this document. Source: RBC GAM, Morningstar Direct

5 Diversification should be measured in decades, not months

Many investors are saving for retirement or some other goal that is often many years in the future. The longer the time horizon, the higher the likelihood of a positive investment return. Looking at the performance of RBC Select Balanced Portfolio is a good example of this. Since inception, the fund has never delivered a negative result over this time frame (Exhibit 6).

Exhibit 6: RBC Select Balanced Portfolio
10-year rolling returns



Note: January 01, 1987 to July 31, 2024 monthly 10-year rolling returns for Series A of RBC Select Balanced Portfolio. See standard performance data at the end of this document for more information. Source RBC GAM

The 60/40 balanced portfolio is far from dead

While it is true that 2022 was a very challenging period for balanced funds, believing the 60/40 portfolio is dead misses the point. The strategy isn't designed to eliminate the potential for losses over very short periods and, over time, it has delivered robust returns while also providing stability, particularly during periods of equity market volatility. Far from being dead, we believe the 60/40 portfolio is poised to deliver performance in line with past experience and that a diversified approach of holding a blend of stocks and bonds will continue to be a successful investment strategy in terms of both returns and risks assumed.

Standard performance data

Fund	1-year	3-year	5-year	10-year	Since inception	Inception date
RBC Select Balanced Portfolio (Series A)	13.1%	3.0%	5.8%	5.8%	6.30%	31-Dec-86

Note: Data as of July 31, 2024. Source: RBC GAM

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