NATIXIS INVESTMENT MANAGERS | SOLUTIONS

PORTFOLIO ANALYSIS & CONSULTING

Moderate Model Portfolio Trends Analysis – Midyear 2023

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Natixis Investment Managers Solutions portfolio consultants monitor asset classes, investment products and market action, both in real time and from a historical perspective. After a tough year for investors in 2022, when both stocks and bonds moved lower, the first half of 2023 has proven to be strong for both asset classes.

With that, can we say it's safe to embrace the traditional 60/40 portfolio again? Well, that depends on how you position your exposure within these asset classes. In our Midyear 2023 Portfolio Trends analysis, we found that financial advisors who have held longer-duration bonds in the fixed income sleeve of their moderate model portfolios have been able to rely on that diversification to counter-balance equity risk.

Higher Duration Paid Off

For example, when there was an equity pullback in early March, the entire yield curve came down as US Treasury prices rose. In just two weeks, the 3–10 Year Treasury Index rose 4.4% – nearly the full-year return an investor in a 3-month T-Bill could expect to receive. As Figure 1 shows, moderate models with the best returns (1st quartile) in the first half of 2023 had the longest duration at 4.5 years. Portfolios with shorter-duration, more cash-like fixed income exposures had lower returns. If the equity markets experience a drawdown later this year, longer-duration fixed income should help offset equity losses. In the Natixis model portfolios, duration is slightly longer than the Bloomberg Aggregate Bond Index, which was 6.3 years as of July 31, 2023.

FIGURE 1 – 1H 2023 Portfolio Returns, Risk and Duration for Moderate Model Portfolio Peer Group

2023 Returns (%) & Risk (%)			
	Return	Risk	Duration (years)
1st Quartile	9.7	15.1	4.58
2nd Quartile	8.2	13.6	4.23
3rd Quartile	7.2	13.3	4.20
4th Quartile	6.7	12.0	4.09
Overall Average	**7.9**	**13.5**	**4.26**

Source: Natixis Investment Managers Solutions

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Maintaining an ongoing partnership with our Portfolio Analysis & Consulting team can help you build your practice and deepen relationships with your clients.

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Advisors Favored Value, But Growth Outperformed

While growth stocks outperformed in the first half, most advisors in our peer group were leaning toward value this year. As of 6/30/2023, 60% of the models had a value bias, while only 17% favored growth stocks. The portfolios leaning toward value posted the lowest returns, with the average return in the 4th quartile at 6.7%, 300 basis points lower than the 1st quartile (Figure 1). Annualized, that's a 6% difference in returns.

So given the strong run that we've had in growth stocks this year, should advisors shift from value to growth? We believe there is a more nuanced way to think about this. Our Portfolio Analysis & Consulting team has developed an inflation/cyclicality framework to answer this question. Rather than focusing on growth and value, the framework drills down to sectors and even industry exposures to assess positioning. It turns out that some industries tend to perform better when economic growth is accelerating – they are more cyclical. Other industries tend to perform better when economic growth is decelerating – they are more defensive. In addition, some industries are better inflation hedges while others benefit from inflation coming down, such as consumer-related industries where customer purchasing power improves as inflation fades.

Inflation/Cyclicality and Portfolio Performance

Figure 2 shows that the best performing portfolios, the 1st quartile, had the lowest inflation score (lower reflects inflation coming down while higher reflects inflation rising). This year, industries that benefit from declining inflation have meaningfully outperformed. In addition, while economic growth has remained resilient, despite so many prognosticators believing that the US economy would go into recession, industries that benefit from growth coming in better than expected have also outperformed. This is demonstrated by the fact that the best portfolios were more pro-cyclically oriented, with a lower cyclicality score. Higher scores are more defensive.

So What About the 60/40 Portfolio?

In our view the 60% stock/40% bond model portfolio is definitely back. However, it is important to position portfolios appropriately within stocks and bonds. On the equity side, this means having a pro-cyclical bias complemented by a growth bias, and leaning away from more defensive equity exposure. This aligns with our more positive view on the equities markets. In fixed income, we prefer to extend duration to at least a neutral position relative to the Bloomberg Aggregate Bond Index. With inflation fading and economic growth remaining resilient, having some duration in the fixed income sleeve will offer some ballast to any equity market volatility we may experience over the remainder of the year.

FIGURE 2 – Best Performing Portfolios Had Lowest Inflation/Cyclicality Scores

	% of Portfolios with Growth Bias	Inflation Score		Cyclicality Score	
1st Quartile	36%	4.33%	Inflation Fade	1.66%	Cyclical
2nd Quartile	26%	5.38%		2.62%	
3rd Quartile	11%	7.50%	Inflation Hedge	2.08%	Defensive
4th Quartile	1%	10.75%		2.59%	
Overall Average	**18%**	**7.08%**		**2.25%**	

Source: Natixis Investment Managers Solutions.

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Natixis Investment Managers Solutions. The Portfolio Analysis & Consulting Moderate Risk Peer Group is based on 321 moderate portfolios submitted for review from January to June 2023. Data as of 6/30/2023.

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