

Edition 02

BlackRock®

The Portfolio of the Future

A spotlight on portfolio trends

An essential series of guides to effective portfolio construction

EDITION
02.

Getting more nimble and granular with asset allocation

In the past, stocks and bonds experienced joint bull markets, but we do not expect this trend to continue. We see the post-pandemic era as being characterised by persistent supply constraints like **shrinking working age populations**, and major structural shifts like digital **disruption linked to artificial intelligence, geopolitical fragmentation**, the **transition to a lower carbon economy** and the **rewiring of supply chains**. We see this leading to **stickier inflation, higher rates, and weaker growth**, making it more important than ever to get the portfolio asset mix right.

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Gone are the days of fixed, set-and-forget strategic portfolio allocations built only with broad equity and bond building blocks

Focus on consistency of portfolio outcomes

Since 2020, equity and fixed income correlations have been pushed further into positive territory (see figure 1). Many portfolio construction processes and risk models rely on low or negative equity/bond correlations to help establish strategic asset allocations and determine the portfolio diversification properties. To add to the complexity, we have also seen market volatility translate into more dispersion in public markets performance¹. Against this backdrop, portfolio resilience has come into question time and again, challenging the more traditional fixed and broad market-cap strategic allocations approach, which focused on public markets only. In this new era, shaped by powerful structural trends, we believe investors using the ‘set-and-forget’ allocation approach may have to tolerate more risk to achieve a similar return.

Not being able to swiftly adapt to the changes in the investment environment, or not distinguishing between the best and worst performing areas of the market, could lead to significant inconsistencies in portfolio outcomes (see figure 2). We believe the portfolio of the future demands a laser focus on portfolio outcomes, delivered through more frequent risk and allocations reviews, considering many market scenarios, through a more granular asset class mix, including private markets. In our view, this will allow investors to be more dynamic to capture new opportunities but also gain more control when outcomes are unfavourable,

Figure 1: equity/bond correlations

Illustration using 12-month rolling index correlations

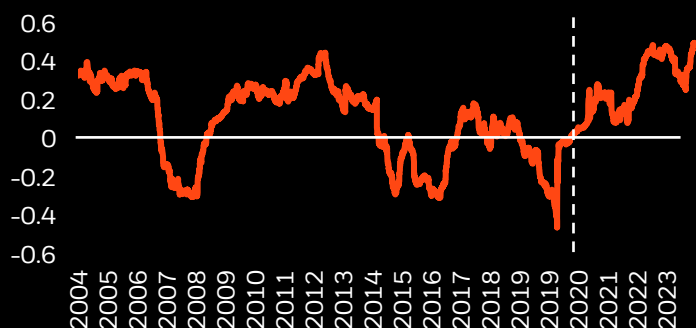
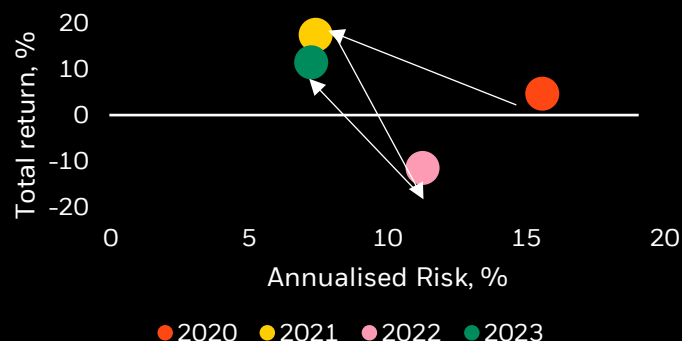


Figure 2: ‘set-and-forget’ allocations

Illustration using a fixed 60:40 portfolio’s performance



Total return, %	06/14 - 05/15	06/15 - 05/16	06/16 - 05/17	06/17 - 05/18	06/18 - 05/19	06/19 - 05/20	06/20 - 05/21	06/21 - 05/22	06/22 - 05/23	06/23 - 05/24
60:40 Portfolio	-3.34	-1.14	11.32	8.47	-0.84	5.66	28.2	-11.49	-0.78	15.58

(Left) Source: BlackRock, MPI. Period: 31 December 2003 – 14 June 2024. Data Frequency: Monthly. Note: 12 m rolling correlations between Bloomberg Global Aggregate Index and MSCI ACWI Index. Currency: USD.

(Right) The figures shown relate to past performance. Past performance is not a reliable indicator of future performance. Index returns do not account for fees. It is not possible to invest directly in an index.

Source: BlackRock, MPI. Period: 31 December 2019 – 29 December 2023. Data Frequency: Daily. Currency: EUR. This information demonstrates, in part, the firm's Risk/Return analysis. This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action. Note: Portfolio 60:40 starting exposures include 60% MSCI ACWI Index; 40% Bloomberg Global Aggregate Index Hdg EUR. ¹ For more on this please refer to Appendix.

Get more dynamic and granular

We think the world is going through a massive shift that is potentially changing the rules of the game for investors. It's caused by three mega forces happening at the same time: artificial intelligence (AI), the rewiring of global supply chains, and the transition to a low-carbon economy. We see the investment environment as one with more unpredictable outcomes, with portfolios having to meet a higher performance bar in the face of higher inflation and rates. This means we need a more agile and selective approach to spot investments that work.

A 'hands-on-the-wheel' approach founded in a more granular mix of assets could allow investors to exploit their skill in timing markets and their ability to consistently pick exposures to the right sectors, regions and styles. We believe this approach will ensure more control over portfolio risk and long-term outcomes, in an increasingly uncertain environment.

The dynamic asset allocation example below illustrates how investors can pivot in reaction to moments in markets which might affect the long-term targets of the portfolio. The investment approach aims to enhance portfolio resilience while capturing investment opportunities.

We focus on a European strategic allocation model, which – instead of being anchored towards a fixed split between equities and fixed income – is targeting a specific level of portfolio risk, to allow for more consistency in performance but also more dynamism in asset allocation adjustments. The model undergoes both ad-hoc and quarterly reassessments and leverages a wide range of very granular building blocks across public equities, fixed income and commodities, including countries, sectors, factors and themes, delivering overall annual portfolio volatility at around 9%.

How can this be implemented?

We believe portfolio builders should be ready to make more nimble asset allocation changes, reflecting on market scenarios and their insights, using investment products that offer the flexibility to be adaptive and enhance alpha, while better managing the portfolio risk budget. This 'whole portfolio', outcome-oriented implementation approach may be crucial for ongoing success and wealth creation for clients in the future, in an environment where the performance bar is higher and the lines between index and alpha-seeking strategies are blurring. Look out Part 3 of this series for more on this topic.

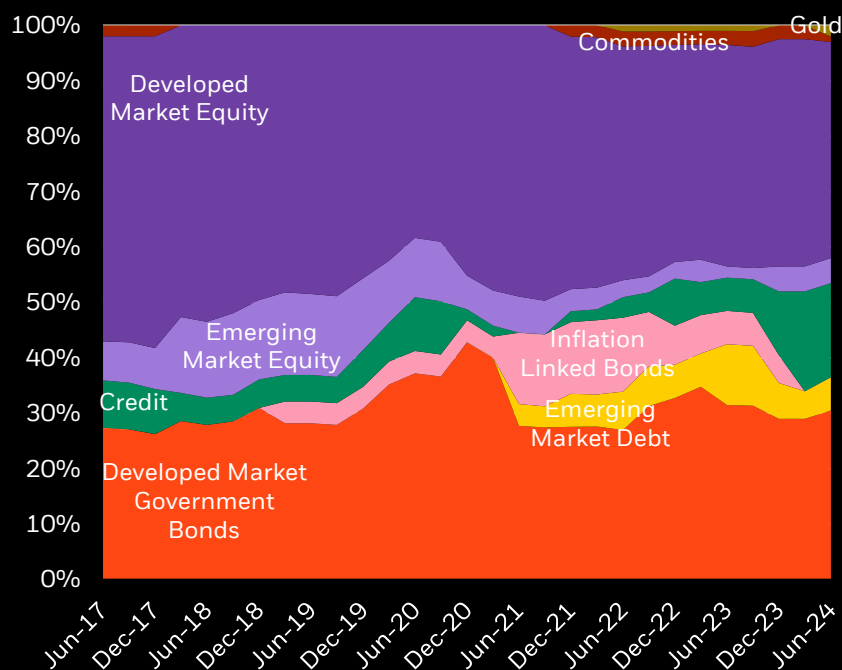
Using this example, we illustrate that:

1. risk-targeted, quarterly asset allocation reviews allow for more adaptable adjustment of the mix of equity and fixed income allocations, delivering consistent experience for clients at the desired risk budget in a complex macro environment marked by sticky inflation and higher rates – see points 1 and 2 in figure 3, where increasing selectivity in both equity and fixed income allows for a wider investment opportunity set in the model on a quarterly basis.

2. working with a more granular range of building blocks allows the model to materially change at times when the new investment environment presents risk challenges – see points 3 and 4 in figure 3, where the model remains risk-on but very deliberate in where risk bets are made, and how they are diversified.

Figure 3: a hands-on-the-wheel approach to navigate the investment regime

Illustration using a target moderate risk model



1 Jun 2023

Adjusting to the **new regime by applying selectivity** through European quality dividend equities and EM debt for their relatively attractive yields.

2 Dec 2023

Maintaining **risk-on stance** as market volatility continued to moderate. Within fixed income, **diversifying government bond** allocation.

3 Mar 2024

Keeping **risk-on stance**. **Introducing Small Cap equities** for attractive valuations. Within fixed income, taking on **more credit risk** through European corporate bonds.

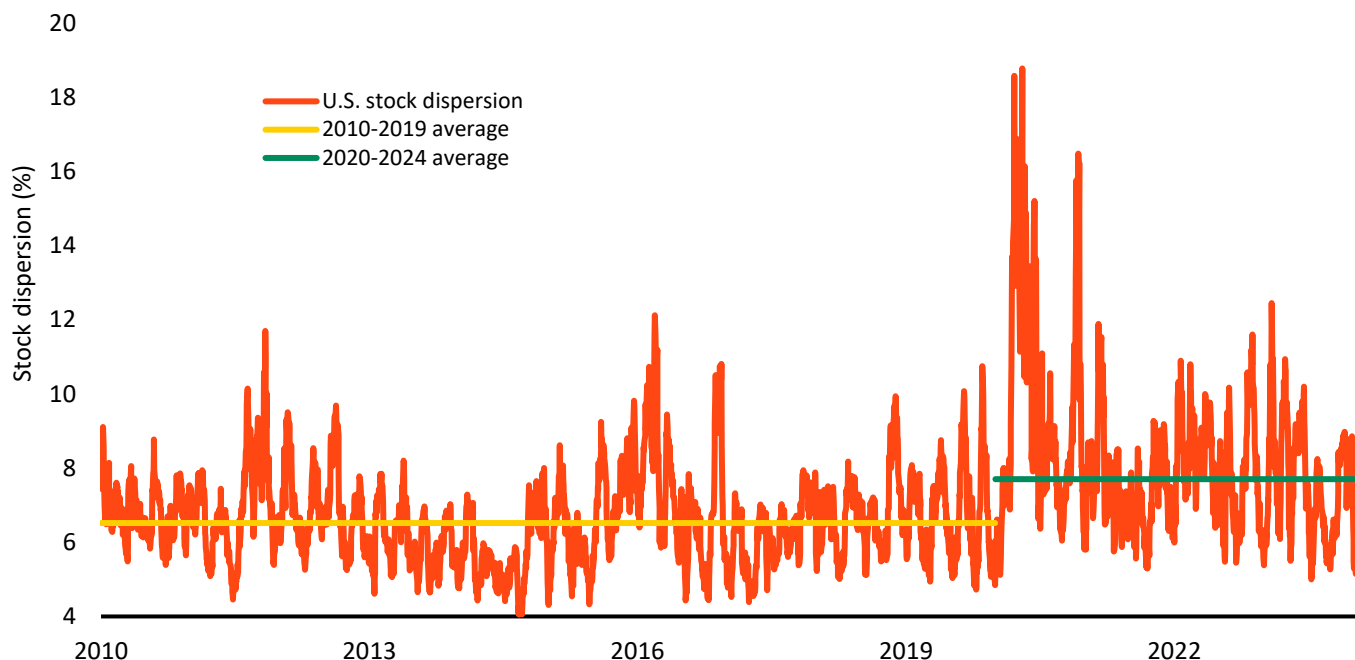
4 Jun 2024

Cautiously remaining **risk-on but** trimming equities to re-calibrate to risk targets. Re-introducing **gold**, in light of rising geopolitical tensions.

For illustrative purposes only. This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise - or even estimate - of future performance. Source: Blackrock, as of 30 June 2024.

Appendix

Dispersion of US stock market (S&P 500) returns, 2010-2024



Past performance is not a reliable indicator of current or future results, and index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, with data from LSEG Datastream, February 2024. Notes: The chart shows the dispersion in S&P 500 monthly stock returns on a daily basis and the median level of dispersion from July 2010 after the global financial crisis through 2019, and from 2020 through 31 January 2024.

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