



QUICK TAKES

Quick Clips: Breaking Beta – Why and How to Diversify

June 27, 2022

Traditional markets have been uncharacteristically kind to investors over the last decade. AQR Principal and Global Co-Head of Portfolio Solutions Group, Dan Villalon, explains why the next one may disappoint—and what investors' main options are to meet their return goals.

Over the past few decades markets have gone from somewhat expensive, to historically expensive. This, along with unusually benign macro conditions, led to windfall gains with unusually low risk for traditional asset classes. Additionally, negative stock/bond correlations allowed investors to rely on bond investments for portfolio protection when equities struggled.

Expected returns for many asset classes are currently at historic lows.

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The next decade may be a sharp departure. Even with losses in stock and bond markets year-to-date, expected returns remain low. Inflation risk has also contributed to stocks and bonds becoming less diversifying to each other, leading many portfolios to offer not only lower returns, but also higher risk than investors have become accustomed to.

Inflation risk helps explain why stocks and bonds are becoming more highly correlated.

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Investors have a handful of options to adapt to the economic environment and the most practical choice may be diversification—specifically adding sources of returns that are currently underrepresented or altogether absent in most portfolios. Crucially, such strategies should have a proven track record of not relying on bull markets for success.

It is important to diversify your diversifiers.

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Diversification has always been a key tenet of portfolio management, but investors may find it even more essential going forward. Succeeding unconventionally is never easy, but the case to do so over next decade is historically strong.

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