Perspectives

Holding Our Breadth

February 6, 2023

Regular readers (and probably not-so-regular ones) have probably noticed I've been talking a lot about value lately (with "lately" being since about 2019!—though an extra focus on value is still the exception that proves the rule). And while I'm all for continuing to shine the spotlight onto this dislocation that, full disclosure, I never thought would happen again post tech-bubble, my colleagues continue to produce a great breadth of research that is, IMHO, eminently worth adding to your non-value reading list.[1]

Here are some of my faves published these past couple months alone:

1. **Fact, Fiction and Factor Investing**
You might think that with all the evidence across lots of geographies, in multiple asset classes, and across many decades, there'd be less debate on factors. You'd be wrong.

Over the past few years, we've addressed some of the biggest debates one factor at a time in a series called Fact, Fiction and Value / Momentum / Size / Low-Risk Investing. We now put it all together for what could be the series finale, Fact, Fiction and Factor Investing.

2. **A Changing Stock-Bond Correlation**
Of all the correlations in the world, the one between stocks and bonds is undoubtedly of greatest interest to investors. This important number was generally negative for the first two decades of the 2000s, but that wasn't the case in the preceding decades, and might not be the case going forward.

Why does this matter? If stocks and bonds (and stock- and bond-related asset classes) become more correlated to each other, then investors' overall portfolios become riskier. This paper considers the implications and, among other things, how much more truly diversifying assets (truly diversifying means really targeting a very low correlation to traditional assets, an issue we may have mentioned before) a portfolio would need to stay within its historical risk budget.

3. **Investing in Interesting Times**
I wish my attempts at market timing were as good (or lucky!) as my colleague Antti Ilmanen's, who published a book titled "Investing Amid Low Expected Returns" in early 2022. But some may now be wondering, given last year's cheapening of asset valuations, if we still live in that low expected return world.

Antti's newest article takes its title after an old (and possibly apocryphal) Chinese curse: "may you live in interesting times." Given the blend of geopolitical turmoil, Fed rate hikes, inflation and/or recession fears, high macro volatility, and only somewhat cheaper asset valuations that are still expensive compared to long-term history, Antti concludes that investors appear to be cursed to live in "interesting times"—but thankfully, he also provides some ways to ameliorate the curse (if these sounds like things we do at AQR it's a complete coincidence). I consider this one to be required reading for investors looking to understand what the jolt of 2022 means for portfolios today.

4. **Capital Market Assumptions**
Something of a tradition for us is our Portfolio Solutions Group's annual Capital Market Assumptions. For a long time now this piece has been routinely depressing, but the good news this year is that it's less depressing than usual—but the bad news is it's not a very dramatic improvement.

Despite the cheapening in many liquid asset classes,[2] we find prices are still higher than anyone would like, meaning expected 5-10 year returns on investor portfolios are probably lower than most people expect and need. The case for truly diversifying sources of returns—i.e., ones not tied to the performance of capital markets—is still strong.

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[1] Don't worry, value fans: that topic does have at least a cameo in each of the pieces here!

[2] I have to specify "liquid" here, because, you know, #volatilitylaundering

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