Portfolio Construction

New Rules of Diversification

How to Prep Your Portfolio for a Different Kind of Recession Risk

Q3 2022

During the first half of 2022, global equity markets tumbled around 20% from their January peak, with losses on typical stock/ bond portfolios almost as large, as bonds offered little refuge. More worryingly, this downturn has a vintage, disco-era look and feel that may be unfamiliar to many younger investors: with inflation still high, there is little prospect of central banks riding to the market's rescue as they did in 2008 and in 2020.

In this article we assess the prospects for stock and bond markets after the H1 selloff, consider the impact of macroeconomic risks on a range of investments, and explore the use of diversifying investments to fortify portfolios.

Diversification away from traditional assets would have paid off in H1 2022 – finally – after many years of tailwinds for stock/bond portfolios. After a small rebound in July, some equity bulls might suggest it's time to 'buy the dip.' While a further recovery is one possible scenario, our analysis suggests that as of summer 2022, the strategic and tactical case for diversification remained strong. Investors cannot expect to time their reallocations perfectly, and it's not too late to diversify. We set out the practical considerations for investors (still) minded to batten down the hatches.

About the Portfolio Solutions Group
The Portfolio Solutions Group (PSG) provides thought leadership to the broader investment community and custom analyses to help AQR clients achieve better portfolio outcomes.

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