



# ALTERNATIVE INVESTING

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## Can Risk Parity Outperform If Yields Rise?

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### *AQR White Paper*

Risk parity investing is, in our view, a reasonable investment strategy which emphasizes diversification over concentration. It is not, as some critics have said, simply “leveraging bonds.” We believe there is strong theoretical and empirical backing to suggest that more diversified portfolios, like risk parity portfolios, can produce superior risk-adjusted returns relative to concentrated portfolios.

Over the long term, we believe risk parity persistently offers a small edge that can compound to a large advantage over time. That edge has held up historically, even during long periods of moderately rising interest rates and even if that cumulative rise in rates is substantial.

To be sure, risk parity investing is not a panacea. If all asset classes go down, a risk parity portfolio will lose money. When equities are soaring, it may do very well but will likely underperform 60/40 equity/bond portfolios and other strategies that load up on equity risk. When interest rates rise sharply — and, more generally, when multiple nonequity asset classes perform poorly — risk parity will, at times, struggle to keep up with equity-dominated portfolios.

However, as this paper demonstrates, risk parity may outperform strategies dependent on equity risk in the long run, even though a prolonged period of rising rates. Anyone evaluating risk parity should consider a range of scenarios, including the equity crash that severely hurts 60/40 investors, as well as more-common situations where some asset classes perform reasonably well and others perform not so well. In these more-common scenarios, diversification would provide meaningful benefit to a portfolio.

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