Employee Benefits Solutions
May 2023

Reimagining the traditional 60/40 portfolio

In the wake of recent challenging investment environments, some market watchers are wondering if the traditional 60/40 portfolio requires reevaluation.

Is the traditional balanced portfolio out of balance?

The 60/40 investment portfolio (diversifying in 60% stocks/40% bonds) has been a mainstay of retirement planning for decades. The strategy was developed in 1952 by Nobel prize-winning economist Harry Markowitz, and quickly became popular with investors because it was an easy approach to long-term investing and generally yielded high returns with low risk. From the 1970s until the early '90s the average yield on a 60/40 portfolio was 5%+.[1]

In theory, the 60/40 mix works because it minimizes risks by relying on a balancing act between stocks and bonds. When stocks go down, the price of bonds goes up. One example of this is when the U.S. Federal Reserve cuts interest rates during a recession to support the economy. With lower interest rates, bond yields go down and bond prices go up — offsetting some of the loss from falling stocks. Until recently, the 60/40 portfolio gave investors the best of both worlds — the potential for high returns when the market was doing well and a cushioning with bonds when stocks dropped.

But the state of the economy and corresponding market activity over the last two to three years has investors and financial professionals questioning if the traditional 60/40 portfolio still applies as a prudent investment approach. What's changed? Mainly higher inflation combined with a sluggish economy. When the economy slowed, the Feds raised interest rates to slow inflation. With higher interest rates, bond values have decreased, compounding the losses seen from an already underperforming stock market.

As illustrated in the following chart, the worst five-year period for bonds* since 2005 was actually very recently – the five-year period ending October 2022. During that time, the bond index was -2.7%.

5-Year Historical Performance (2005–2022)

	Average 5-Year Return	Maximum 5-Year Return	Minimum 5-Year Return
Bond Index	21.3%	39.7%	-2.7%

*Bloomberg US Aggregate Bond Index Total Return USD and is measured on the last day of each month.

Some are saying, "the 60/40 portfolio is dead." This may be an extreme position. The 60/40 portfolio isn't "dead" – but it may need some re-imagining. Diversification will continue to be an important component of long-term investing. It is still the best way to minimize losses and improve the likelihood of higher returns. However, there are some excellent alternative investment tools available that can fill in the gaps where the 60/40 portfolio falls short. Taking advantage of these tools can set you apart from your competition.

Asset managers and financial professionals are looking for ways to improve the 60/40 portfolio, including adding alternatives.

The reliable correlation between bonds and equities has supported the traditional portfolio for decades. However, there have been a few times over the years when the reliability of this portfolio mix was exposed. In 2022, the steep decline in the bond market caught investors off guard. Instead of offsetting equity losses, bonds contributed to negative portfolio returns overall. Some decline in the bond market was expected, but investors faced the most severe drop in over a century. As any financial professional knows, it's virtually impossible to make up the losses from a steep market downturn. For example, a 20% loss in the market (over a two-year period) can't be fixed with a 20% recovery. The investor would actually have to get 25% gains to get back to where they were, and even more than that to make up for the two years they missed out on returns.

Understandably, your clients want some protection from a volatile stock market, but there simply aren't many good alternatives to a traditional bond hedge. That's why many financial professionals are increasingly looking to less traditional tools, like annuities, to fill the gaps.

Identifying gaps in traditional 60/40 portfolios

When the traditional 60/40 mix isn't working, the first step is to identify where the gaps are in a client's portfolio.

Think about the gaps in a traditional portfolio by considering the following:

1. Retirement income. Will your clients have enough income in retirement? If your clients are nearing retirement, they don't have the luxury of waiting for the economy to turn around. They need a reliable source of income that is steady and will grow over their retirement.
2. Major health events. The risk of a serious health event increases with age, and if your clients don't have adequate health coverage, they may be forced to use most of their retirement savings to cover the costs.

3. Longevity risk. Longevity risk is perhaps the biggest risk to a financially secure retirement. Simply put, it's the risk your clients will live longer than they expected and won't have the resources to support themselves in the later stages of their life.
4. Sequence of returns. It's not just how much investments go up or down, but when the ups and downs occur. It can become a risk when your clients approach retirement and begin making withdrawals. If they are fortunate enough to experience strong returns in the early years, they may not have any problems. But poor returns and withdrawals early in retirement can do lasting damage to a portfolio.

Harnessing the power of annuities

Once the gaps in traditional 60/40 portfolios are identified, it is essential for financial professionals to adapt by leveraging alternative strategies, like annuities. Annuities are insurance contracts that pay out invested funds as fixed income usually when a client retires. They provide a steady flow of cash and are most appropriate for older clients who want a stable and guaranteed retirement income. They also work well for clients with a "retirement gap" — those individuals who have less saved for retirement than they will need. Annuities are excellent alternatives to bonds and can be structured to meet your clients' unique circumstances. Investors can fund their annuity with either a lump sum or periodic payments during the accumulation phase. The annuity can be set up to pay out a monthly sum to your clients for the remainder of their lives.

Familiarize yourself with the following types of annuities when you're considering the appropriate mix for your clients' portfolios:

Fixed annuities

Fixed annuities are a financial product that guarantees a specific rate of return and can provide an income stream in retirement. With a fixed interest rate, investors know in advance how much annuities will grow and how much income they could pay out. Benefits:

- Guaranteed protection of your principal against investment loss
- Guaranteed interest rate for a set period of time
- Tax deferral, instead of paying taxes on gains each year, they are deferred until withdrawn and can generate interest gains
- Options for receiving income in retirement, including the ability to create a guaranteed stream of income that can't be outlived

A fixed annuity may be appropriate for clients who are more conservative, want a guaranteed rate of return and are not concerned about liquidity for the duration of any surrender period.

Fixed index annuities

Fixed index annuities are a type of annuity contract that provides steady retirement income payments that are based on the performance of an underlying equity market index. Benefits:

- Interest crediting that tracks the performance of an index
- Protection from negative market performance, since interest credited can never be less than zero
- Locked-in interest earnings, with the potential for continued future growth
- The ability to accumulate savings faster through tax-deferred compounding
- Options for receiving income in retirement, including the ability to create a guaranteed stream of income that can't be outlived

A fixed index annuity may be appropriate for clients who are concerned about market downturns but still want to experience some growth. They may be willing to sacrifice receiving the highest returns in exchange for knowing they won't experience a loss due to market performance.

With fixed index annuities, clients can choose a crediting method, either a cap rate or a participation rate. The following chart gives an example of how both crediting methods with the S&P Index performed against the bond index.

5-Year Historical Performance (2005–2022)

	Average 5-Year Return	Maximum 5-Year Return	Minimum 5-Year Return
Bond Index	21.3%	39.7%	-2.7%
8% S&P Cap	32.2%	45.2%	16.6%
40% S&P Par	26.2%	49.5%	9.1%

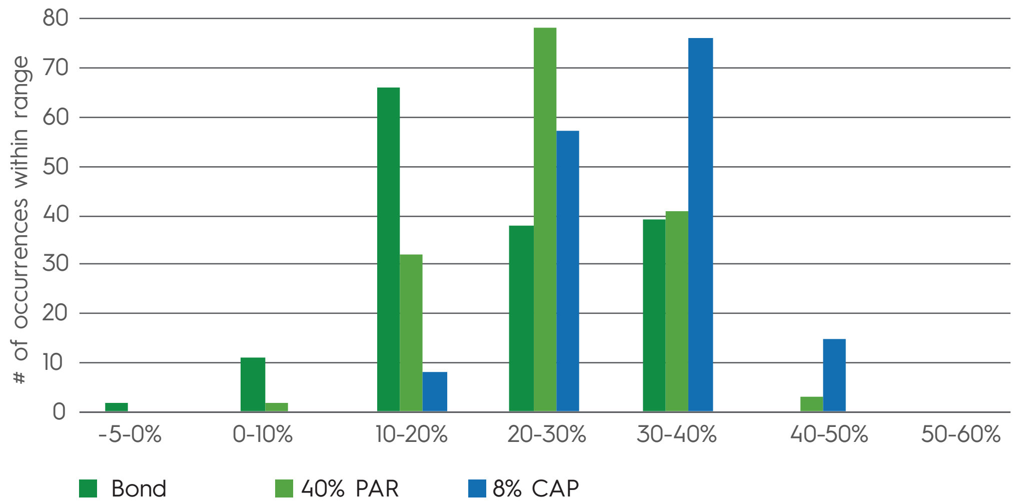
5-year performance results for S&P Cap rate and S&P Participation rate.

For comparison's sake, you can see the range of five-year historical returns of the bond index again, but this time we are adding in the five-year historical returns of two variations of a fixed index annuity. For both variations over five years, the fixed index annuity would have allowed a policy owner to participate in some of the S&P index gains, but not participate in bond index downturns.

On the next page is a frequency chart with another view of this same comparison. The table shows how many five-year returns fell within each range. For example, the number of times the returns were greater than 20% was 77 times. But the 40% Par was above 20% 122 times and the 8% was above 20% 148 times.

Out of the 156 five-year periods, the 8% cap outperformed the bond index in 115 periods (74% of the time), and the 40% Par outperformed the bond index 105 times (67% of the time). An annuity purchase has additional considerations such as liquidity, charges and expenses (surrender charges).

DISTRIBUTION OF BACKTESTED 5-YEAR RETURNS



Registered index-linked annuities (RILAs)

Registered index-linked annuities (RILAs) are tax-deferred long-term savings options that limit exposure to downside risk and provide the opportunity for growth. They offer more growth potential than a fixed index annuity but less potential return, and less risk than a variable annuity. You can also dial in the amount of market exposure from year-to-year. One downside to RILAs is that there isn't much flexibility once they're purchased. If the world changes or your clients' circumstances change, you can't make adjustments.

A registered index-linked annuity may be appropriate for clients who are in or near retirement. They want equity-like returns if the index performance is positive and a level of protection if index performance is negative. They want tax-deferred growth potential.

Investment portfolios and appropriate mix of investments depend on your clients' personal circumstances and objectives. To build a strong portfolio, it's paramount to consider your clients' financial goals, risk tolerance and time horizon.

However, many clients are unprepared to answer these questions. A recent survey found that 37% of Americans have done no planning for retirement.[2] Most of your clients may only have a vague sense of what they want retirement to look like for them. Therefore, it's worth your time as their financial professional to help them clarify their goals. Doing so will not only help your clients stay focused as they save for retirement, but it will make it much easier for you to build a winning portfolio. You should be asking your clients the following questions before choosing their investments:

- What age do you want to retire?
- How much stock market volatility are you comfortable with?
- Do you wish to pass along wealth to children, grandchildren or charities?
- What other key financial goals and milestones do you expect to have along the way?

The more you know about your clients' personal circumstances and objectives, the easier it will be to build a portfolio that meets their expectations and can weather the ups and downs in the market.

Regardless of the markets and the state of the economy, what will be true will always remain true.

Don't wait to talk to your clients about alternative investment strategies like annuities. Whether you're hearing from them or not, your clients are concerned about their financial future.

A recent Lifetime Income survey found that while 80% of Americans are interested in guaranteed monthly income in retirement, most aren't familiar with annuities and only 14% of investors currently have an annuity in their portfolio.[3] Many investors have biases about these less traditional investment strategies. For example, they may believe annuities are "too expensive," which is simply not true. Debunking such myths will go a long way toward creating trust with your clients and setting them on the path to financial security.

The 60/40 strategy is a "one-size-fits-all" approach. By considering alternative tools, like annuities, you'll have more flexibility to adapt to your clients' changing circumstances and the ever-changing economy.

You can set yourself apart as a financial professional by offering these alternative investment strategies. By staying ahead of the trends, you can outpace your competition.

Leverage annuities as an opportunity to set yourself apart.

Learn more

For more information on how you can fit annuities into your practice, contact the annuity sales desk at **1-866-335-7355.**

1. Lin, Wendy. "Is the 60/40 dead?" GSAM Connect, gsam.com, Jan. 30, 2023.
2. Deaton, Holly. "Most Americans have no financial plan. The ones who do praise the benefits." RIA Intel, ria.com, May 27, 2022.
3. "Why do 84 percent of retirees want annuities but only 14 percent buy them?," Annuity Guys, annuityguys.com, July 8, 2018.

An annuity is intended to be a long-term, tax-deferred retirement vehicle. Earnings are taxable as ordinary income when distributed, and if withdrawn before age 59½, may be subject to a 10% federal tax penalty. If the annuity will fund an IRA or other tax qualified plan, the tax deferral feature offers no additional value. Qualified distributions from a Roth IRA are generally excluded from gross income, but taxes and penalties may apply to nonqualified distributions. Please consult a tax advisor for specific information. There are charges and expenses associated with annuities, such as deferred sales charges (surrender charges) for early withdrawals.

The guarantees are subject to the financial strength and claims-paying ability of the issuing insurance company.

These materials are for informational and educational purposes only and are not designed, or intended, to be applicable to any person's individual circumstances. It should not be considered investment advice, nor does it constitute a recommendation that anyone engage in (or refrain from) a particular course of action. Securian Financial Group, and its subsidiaries, have a financial interest in the sale of their products.

The indexes are not available for direct investment.

S&P is a registered trademark of Standard & Poor's Financial Services LLC ("S&P") and Dow Jones is a registered trademark of Dow Jones Trademark Holdings LLC ("Dow Jones"). The forgoing trademarks have been licensed for use by S&P Dow Jones Indices LLC. S&P and S&P 500 are registered trademarks of S&P and have been licensed for use by S&P Dow Jones Indices LLC and Minnesota Life Insurance Company ("Minnesota Life"). The S&P 500 index is a product of S&P Dow Jones Indices LLC and has been licensed for use by Minnesota Life. Minnesota Life Indexed Annuities are not sponsored, endorsed, sold or promoted by S&P Dow Jones Indices LLC, Dow Jones, S&P or their respective affiliates and neither S&P Dow Jones Indices LLC, Dow Jones, S&P nor their respective affiliates make any representation regarding the advisability of investing in such product(s). Index performance, if shown, does not include dividends.

Insurance products are issued by Minnesota Life Insurance Company in all states except New York. In New York, products are issued by Securian Life Insurance Company, a New York authorized insurer. Minnesota Life is not an authorized New York insurer and does not do insurance business in New York. Both companies are headquartered in St. Paul, MN. Product availability and features may vary by state. Each insurer is solely responsible for the financial obligations under the policies or contracts it issues.

Securian Financial is the marketing name for Securian Financial Group, Inc., and its subsidiaries. Minnesota Life Insurance Company and Securian Life Insurance Company are subsidiaries of Securian Financial Group, Inc.

For financial professional use only. Not for use with the public. This material may not be reproduced in any way where it would be accessible to the general public.

securian FINANCIAL®
INSURANCE
INVESTMENTS
RETIREMENT

securian.com

400 Robert Street North, St. Paul, MN 55101-2098

F103037 6-2023 DOFU 6-2023
2711476