MOVING beyond the 60/40 investment portfolio

What will be required to facilitate the movement among RIAs from stock-and-bond portfolios to an endowment-style mix of stocks, bonds, alternatives and real assets?

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Fundamentally, it is a question of adviser motivation. Having benefited from both steadily declining interest rates and the longest equity bull market in history, advisers have had little need to seek out other asset classes. However, looking forward, as interest rates now steadily rise, and equities experience late-cycle expansion characteristics (e.g., higher volatility, a reversion to the mean, a potential correction), a 60/40 stock-and-bond portfolio is unlikely to produce the same results as it has over the past few decades. The only way forward-thinking RIAs will be able to meet their clients' financial goals will be through the addition of nontraditional portfolio-diversifying investments, such as real assets, that not only have a low correlation to stocks and bonds, but also have the potential to reduce portfolio volatility while producing steady income. This, of course, assumes the adviser has determined whether nontraditional investments are suitable for his or her client.

Two major items that will help the RIA industry encompass the endowment-style focus will be (a) true fiduciary, by removing any incentives from the adviser to sell any products or receive hidden compensation such as variable adviser fees for different products or strategies; and (b) education and support from educational firms and boards, such as CFP and CFA, to incorporate the endowment-style model as a strategy in portfolio diversification. This will create the grassroot changes for the next generation and possibly get RIAs of the current generation to consider such a change.

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Education! As an RIA you have a fiduciary duty to your clients. That includes stepping out of your comfort zone to learn about current asset-allocation strategies relevant to this present economy. Financial advisers who are still operating a 60/40 stock-and-bond portfolio need to be educated and need to learn how endowments invest now. The idea behind the 60/40 portfolio dates back to strategies implemented by pension funds and endowments, where the mix would provide growth from equities while bonds would smooth the volatility. It worked well back then, but they evolved decades ago toward real assets and other alternatives as a core to their portfolios. Endowment funds are perhaps the best long-term investors because they understand the need for long-lasting income streams. Educating ourselves is a must when stocks can't carry your clients' portfolio, and bond yields are too low to recover losses.

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RIAs need access to not only quality product offerings with attractive fee structures, but also investment offerings with regularly updated pricing information. In the past, many RIAs have been interested in providing their clients more diversified products, but lack of adequate pricing data has prevented RIA use because of SEC requirements. As managers and sponsors provide quality investment offerings that meet both of these criteria, RIA adoption will continue to rise. In addition, higher valuations in stocks, combined with poor fixed-income prospects should heighten RIA interest, and even a shallow market correction is likely to accelerate wider adoption of portfolio-diversifying investments.

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The answer to this question is *education*. The alternative investment industry needs to do more to educate RIAs and the public regarding the benefits of alternatives and real assets being included in portfolios. In addition, the RIA and broker/dealer world needs to be more receptive to that education. The world has changed and so has the need for new investment strategies that offer diversification and non-correlation with the market. David Swenson, CIO for the Yale Endowment Fund, has proven the benefits of diversification using alternative and asset-backed investments, whether that be venture capital, private equity, real estate and asset-backed debt programs, or other alternative investments. There is much to be learned by all regarding the endowment approach to investing.