Retirement News Highlights

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Cambridge's Celia Dallas on the death of 60/40, geopolitical risk and inflation

By Erin Arvedlund
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Is the longtime asset allocation model known as 60/40 — 60% equities and 40% fixed income — now history?
After years as the typical path to diversify investment portfolios, the 60/40 model has fallen out of fashion as the best way to achieve high performance with limited risk, said Celia Dallas, Cambridge, Mass.-based chief investment strategist at Cambridge Associates LLC, in an interview.

"I'm often asked that question: Is 60/40 dead? It died a long time ago. Look, it's a reasonable baseline. If I were to define my return and risk objectives, how would I do that with stocks and bonds? Over long spans, it's a useful way of expressing a 5% expected real return. It's a logical point."

However, the firm's strategy is to add diversification beyond 60% equity and 40% bonds to add upside while taking comparable levels of downside risk.

"That's the philosophy behind diversified portfolios," she said.

Ms. Dallas, who has worked at Cambridge for 27 years, focuses on setting the consultant's house view for strategic asset allocation and investment policy.

Cambridge Associates has about $548 billion in assets under advisement and $67 billion in assets under management.

A new regime

Some investment firms such as private equity and buyout giant KKR & Co. Inc. argue that a 40/30/30 portfolio is the new regime.

KKR in a 2022 paper argued that the traditional allocation was broken after 2022, and in an inflationary climate, it's better to improve the 60% tranche of the typical 60/40 portfolio with more yield and inflation protection through the use of alternative investments. KKR called for a new regime: a 40/30/30

portfolio, which substituted 20% of the public equities with a combination of 10% private real estate and 10% private infrastructure, and replaced 10% of the traditional bond allocation with 10% of private credit.

It's a model with which Ms. Dallas is familiar.

"We lean heavily into illiquid assets, in particular venture capital and private equity. That's value-added returns through active management. That's most fruitful in venture capital and private equity," she said.

"We build bespoke portfolios for our clients, so I can't say we do 40/30/30. Some of our clients have a profile more similar to a 70% equities/30% bonds portfolio, while others might be closer to 50/50. In some cases we go well over 30% alternatives."

For sure, persistent inflation has changed the conversation with pension funds and other investors that have fixed liabilities.

"We're not in the camp that inflation is runaway. It's gotten higher for longer than we thought. Clearly inflation's coming down, but it will remain at higher levels than we saw pre-COVID," perhaps above where most central banks are targeting at 2% annually.

"We could easily see inflation at 3% to 4%. Markets can adjust to higher inflation as long as it's not hugely volatile."

From an investment perspective, "we've seen more interest in assets that do better in an inflationary environment. That includes infrastructure and inflation-linked bonds."

Real assets, including real estate, that she prefers "are less leveraged and that can reset rents more quickly. High-quality stocks and value stocks do well in a higher-rate and higher-inflation environment."

Growth and diversifiers

Ms. Dallas said she classifies assets for growth and diversification. Those include public and private equities, hedge funds, public and private credit, investment-grade bonds and real assets.

Generally, Cambridge use two lenses to evaluate asset classes: "We recognize that strategies are multi-purpose. A hedge fund could be more aggressive and fit in a growth mandate; another could be defensive and different sources of return and belong as a diversifier," Ms. Dallas said.

Recently, pension funds have been asking more about private credit.

"We've been seeing high interest for some time in private credit. The bank failures caused banks to pull back lending even further; it's an opportunity for private credit to step into the gap. They charge increased rates with higher covenants. That's quite attractive to pension funds, which are getting higher quality, more stable returns through direct lending."

Interest has stepped up "as valuations got more appealing and protections increase. Private lenders get stronger covenants in this environment."

Green metals

One area Ms. Dallas is focused on with the energy transition is so-called green metals such as lithium, copper, cobalt and nickel.

"We like green metals for a long-term perspective. There's secular support relative to the energy transition" away from fossil fuels to other types. "There's a shortage of supply relative to demand from makers of electric vehicles, solar and wind."

The challenge is that "near term (these metals) are primarily used for industrial purposes. If the economy slows, and China's successful in converting to a more consumer-driven economy, that demand will fall. In the near term we play that through alternative battery formulas; improved mining processes and battery recycling. These are strategies you might find through venture capital and private equity."

Conversations on China

Among future worries, investors are closely watching the "concerning" geopolitical environment, Ms. Dallas said.

Take China: "There's clearly a risk premium priced into China. We may see it priced into other markets as time goes by. Chinese equities are trading at a big discount. There's concern about U.S.-China policy and globally the intermingling between technology and national security. You can't decouple technology because supply chains are so intertwined."

China comes up as a topic for many clients, she said, and "we have conversations around them. It's the second-biggest economy in the world. About 7.5% of U.S. revenues come from China, and it hasn't decreased. We're always going to have exposure."

The client has to be comfortable with Cambridge's path of investing, she said. "We get questions from clients about not just China, but other emerging markets, and working through what kind of policy to have around that."

Geopolitics and the continued tension between the U.S. and China may also contribute to an ongoing higher level of inflation.

If these tensions continue, these geopolitical concerns "are supportive of a higher level of inflation over the long term. It's the redundancy being built into supply chains which raise costs — favoring security over profit maximization."

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Private equity fundraising down 35% in Q2, Preqin says

By Arleen Jacobius
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Private equity funds worldwide had a difficult time on the fundraising trail in the second quarter, raising a combined $106.7 billion, down from $164.4 billion in the prior quarter and also down from $165.3 billion in the year-earlier quarter, according to a just-released Preqin report.

The majority of the funds still in the market attempting to raise capital in the second quarter were either buyout or growth capital with 1,150 buyout funds seeking to raise an aggregate $722.2 billion in capital and 1,202 growth funds aiming to raise a combined $314 billion in capital.

Venture capital funds worldwide fundraising also continued a downward trajectory, raising a total of $26.1 billion in the second quarter, a drop from $34.9 billion in the first quarter and down from $61.6 billion in the quarter ended June 30, 2022.

Of the 6,230 venture capital funds in the market seeking to raise a total of $451.9 billion in the second quarter, 2% of the number of funds and 28% of the aggregate capital targeted were for funds attempting to raise the largest funds of $1 billion or more. The largest share of the venture capital funds in the market were for small funds of $100 million or less, representing 62% of the fund in the market in the second quarter and 15% of the aggregate capital targeted were for funds aiming to raise.

Private debt funds raised a combined $71.2 billion in the second quarter, up from $38.6 billion in the first quarter but down from $80.2 billion raised in the second quarter of 2022, which was a record fundraising quarter for the asset class.

There were 1,032 private debt funds in the market in the second quarter attempting to raise a combined $420 billion. Most of them were direct lending funds, representing 52.7% of the funds (544 funds) and 60% of the aggregate capital targeted ($251.5 billion).

Real estate funds worldwide had some fundraising success in the second quarter, raising a combined $57 billion in the second quarter, more than double the $22.7 billion raised in the first quarter and an increase from $44.4 billion raised in the year-earlier quarter.

The number and amount of real estate fund closed was but a sliver of the 2,183 real estate funds in the market in the second quarter aiming to raise a total of $577.8 billion in capital. Only three natural resources funds closed in the second quarter with a combined $1.9 billion, up in terms of capital raised from $1.1 billion raised by six funds in the first quarter and $1.6 billion raised by 10 funds in the year-earlier quarter.

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