Why the 60/40 Stock/Bond Rule is Stupid

- The 60/40 Stock/Bond Rule is ubiquitous, and that's stupid because it's just not right for everyone.
- Asset allocation is the most important decision, and is designed to achieve objectives. Risk preference needs to be controlled by risk capacity.
- It's easy to be smarter than 60/40

For decades, the "go to" asset allocation used by most investment advisors is 60% in equities and 40% in bonds, but this is a stupid choice for many investors. Asset allocation is the most important investment decision because it explains 100% of investment performance. Check your own asset allocation. Is it 60/40 or near that ratio? Why?

The Employee Benefit Research Institute (EBRI) reports that the average IRA account is 60/40 regardless of age. Also, the $2 trillion in target date fund investments is 60/40 at the target date. 60/40 is ubiquitous, and it's stupid because it's just not right for everyone. Nothing is a true "Goldilocks portfolio."

Why 60/40 is stupid

We all have unique needs and circumstances, so one-size-fits-all is stupid. Asset allocation is a risk decision designed to achieve our unique objectives. We have a risk "preference" for a particular asset allocation, and there's a good chance it's not 60/40. Furthermore, our risk "preference" should be limited by our risk "capacity." There's a time in all of our lives when we should avoid the risk of losing money because our savings are at their peak, and we don't have time to recover from a big loss. Losses sustained in the "Risk Zone" transition from working life to retirement can ruin lifestyles and shorten the life of savings, even if markets subsequently recover. There are 78 million baby boomers in the Risk Zone, many of whom are invested 60/40, a mix that lost more than 30% in 2008.

What’s smarter?

Most advisors use models, which are pre-established asset allocations tied to various risk preferences. The model in the middle of the list, midway between Aggressive and Conservative (“Goldilocks”), is generally 60/40. That’s why this choice is so popular. But that’s not the biggest problem. The biggest problem is that advisors use models that totally ignore risk capacity. One of the proofs of this problem is the fact that the average IRA is 60/40 regardless of age.

Investors in their 50s, 60s and 70s are in the Risk Zone and should be protecting their savings because it’s the smart thing to do. There are better models that integrate risk preference with risk capacity, and they are much safer than 60/40 in the Risk Zone.