Quick Take: Low Risk Equities—Well Suited to Economic Headwinds

September 2022

Fed hikes aggressively to regain price stability, even at risk of recession

- Whereas the Fed's July rate hike had merely brought borrowing costs back to 2018 levels, its latest 75bp increase pushed the fed-funds rate to its highest level in 15 years.
- Nonetheless, real rates remain historically low, suggesting that the Fed may still have a long way to go. Amid growing concern that hawkish policy will lead to a "hard landing," the Treasury yield curve has inverted, a pattern that often is interpreted as a harbinger of recession, and the stock market has resumed its 2022 slide.

Low risk portfolios: Well suited to current economic headwinds

- With respect to inflation, low volatility portfolios typically overweight sectors, specifically staples, health care, and utilities, that have performed comparatively well during past periods of high reported inflation.
- With respect to recession risk, the top chart shows that, over a near century-long history, a hypothetical minimum variance portfolio generates strong active returns when equity multiples contract. The bottom chart explicitly maps the pattern to the business cycle, showing that the low vol portfolio produces significantly higher returns than the cap-weighted market during recessions, with nearly full upside capture in other periods.
- Looking forward, we see timely appeal in low vol equities, given the combination of stubbornly high inflation, the Fed's apparent resolve to regain price stability and maintain its credibility, and U.S. valuation multiples that remain historically elevated despite the recent selloff.

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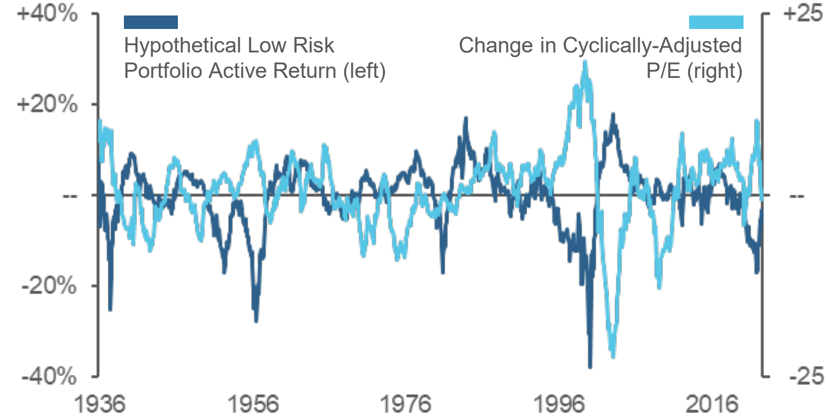
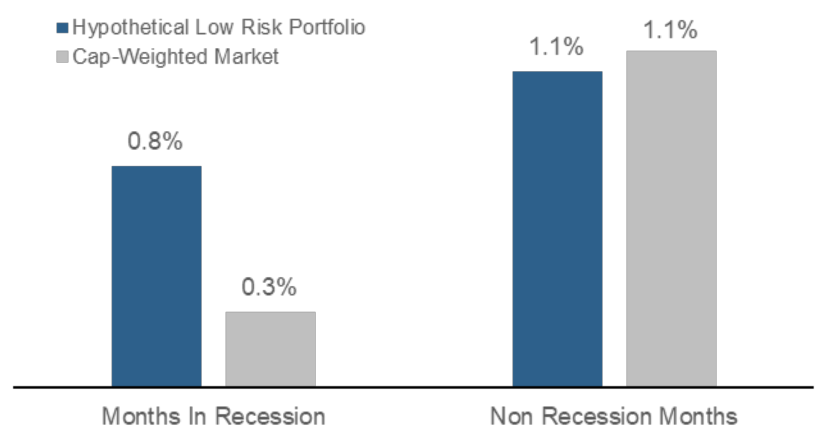
Low Risk Portfolio Active Returns and Change in CAPE (3Y rolling)



Low Risk Portfolio and Market Returns (1933-Jul 2022)



Hypothetical low risk portfolio is a U.S. minimum variance portfolio based on a rolling 5-year covariance matrix, rebalanced monthly. Cap weighted market is CRSP Value-Weighted Index. Sources: Acadian based on data from U.S. Stock Databases, Center for Research in Security Prices (CRSP), The University of Chicago Booth School of Business and Robert Shiller Online data, Yale School of Management. Exhibits are educational illustrative examples and do not represent investment returns of an actual portfolio. Analysis uses the whole CRSP universe of U.S. securities. Results do not represent actual trading or an actual account, do not reflect transaction and other implementation costs, and do not reflect advisory fees or their potential impact. Hypothetical results are not indicative of actual future results. Every investment program has the opportunity for loss as well as profit.

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