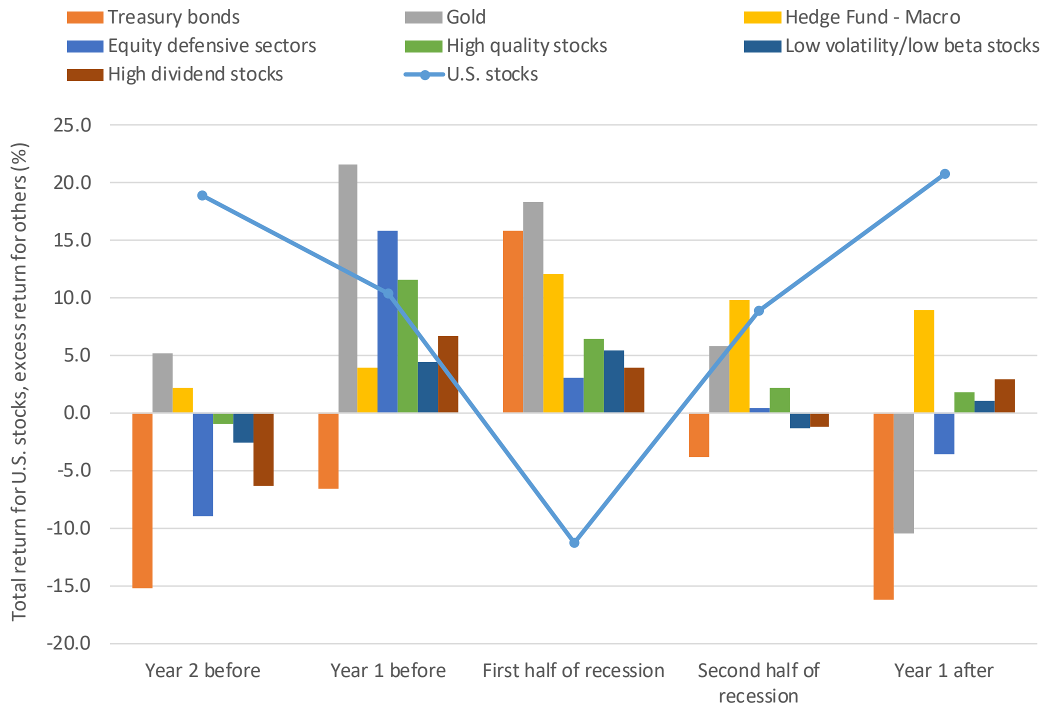
October 16, 2019

The Value of Defensive Assets Leading into a Recession



Source: Wells Fargo Investment Institute, Bloomberg, Morningstar, AQR, October 1, 2019. Chart shows average return before, during and after past recessions from January 1926 to September 2019. Market indices: Large-cap stocks - Ibbotson large stock Index; Treasury bonds – Ibbotson Government bond Index; Gold – Bloomberg Gold Index; Hedge Fund – Macro – HFRI Macro Index; Equity defensive sectors – average of S&P 500 Consumer Staples, Health Care, Utilities, Communication Services sectors; High quality stocks – AQR Quality Index; Low volatility/low beta stocks – MSCI USA Minimum Volatility Index; High dividend stocks – MSCI USA High Dividend Index. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Historical asset performance is diverse at turning points in the business cycle

As of October 2019, the U.S. economic expansion has lasted 126 months, the longest expansion in U.S. recorded history. While we don't expect an imminent end to the expansion, the economy is beginning to slow, and we foresee significant bouts of equity market volatility in the coming year.

Historically, defensive assets and strategies have helped mitigate equity market losses. Between January 1926 and September 2019, U.S. Treasury bonds, precious metals (such as gold), and certain hedge fund strategies outperformed equities in the 12 months before a recession and through the first half of a recession. Within equities, high quality, low price volatility, low market beta (volatility), and high-dividend stocks historically have weathered late-cycle economies and recessions well.

What it may mean for investors

We recommend that investors incorporate defensive strategies into portfolios to help mitigate risk and navigate through uncertain times. Investors who react out of fear may elect large cash positions that, over time, could impair their longer-term potential returns and endanger their financial goals.

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This chart was excerpted from the Investment Strategy report dated October 7, 2019.

Risks Considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. There is no guarantee that dividend-paying stocks will return more than the overall stock market. Dividends are not guaranteed and are subject to change or elimination. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. Investments in **gold** and gold-related investments tend to be more volatile than investments in traditional equity or debt securities. Such investments increase their vulnerability to international economic, monetary and political developments.

Hedge fund strategies, such as Equity Hedge, Event Driven, Macro and Relative Value, may expose investors to the risks associated with the use of short selling, leverage, derivatives and arbitrage methodologies. Short sales involve leverage and theoretically unlimited loss potential since the market price of securities sold short may continuously increase. The use of leverage in a portfolio varies by strategy. Leverage can significantly increase return potential but create greater risk of loss. Derivatives generally have implied leverage which can magnify volatility and may entail other risks such as market, interest rate, credit, counterparty and management risks. Arbitrage strategies expose a fund to the risk that the anticipated arbitrage opportunities will not develop as anticipated, resulting in potentially reduced returns or losses to the fund.

Definitions

AQR Quality Index comprises listed U.S. stocks and weights companies by composite of profitability, growth, safety and payout.

Bloomberg Gold Index is a commodity group subindex of the Bloomberg Commodities Index composed of futures contracts on Gold.

HFRI Macro (Total) Index. Encompass a broad range of strategies predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard-currency, and commodity markets. Managers employ a variety of techniques, both discretionary and systematic analysis, combinations of top-down and bottom-up theses, quantitative and fundamental approaches and long- and short-term holding periods. Although some strategies employ RV techniques, Macro strategies are distinct from RV strategies in that the primary investment thesis is predicated on predicted or future movements in the underlying instruments rather than on realization of a valuation discrepancy between securities. In a similar way, while both Macro and equity hedge managers may hold equity securities, the overriding investment thesis is predicated on the impact movements in underlying macroeconomic variables may have on security prices, as opposed to EH, in which the fundamental characteristics on the company are the most significant are integral to investment thesis.

Ibbotson Large Stock Index is a market-capitalization-weighted index of the large cap U.S. publicly traded companies.

Ibbotson Government Bond Index is an unweighted index which measures the performance of five-year maturity U.S. Treasury Bonds.

MSCI USA Minimum Volatility Index comprises listed U.S. stocks and weights companies by standard deviation of total returns.

MSCI USA High Dividend Index comprises listed U.S. stocks and weights companies by dividend yield.

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S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

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