Allianz Global Investors

“Breaking the barbell” – time for a more active approach to diversification?

Is it time to break the barbell? A “barbell” is the name we give to a portfolio that balances US equities at one end and cash at the other – mostly at the expense of other assets, notably bonds.

A 15-year bull market has pushed US financial wealth and equity allocations to record highs, leading to widespread use of the barbell portfolio. Meanwhile, assets in US money market funds exceeded USD 7 trillion in November 2024 – a record – while bond allocations have shrunk to all-time lows.

Is the barbell due a rethink?

- While we expect a more modest continuation of the trend of US equity outperformance, our research highlights the need for active diversification.
- History shows that once an equity bull run ends, bonds tend to outperform (see chart).
- Furthermore, diversification has historically had its greatest benefits in an environment of heightened inflation risk.

To test the resilience of a barbell portfolio, we compared its performance to that of a more diversified portfolio, adding non-US equities, developed and emerging market bonds, commodities and gold.

Our findings? While concentrated US equity exposure has performed remarkably well in many market environments, in three out of four historical scenarios, **the diversified portfolio matched or outperformed the barbell for risk-adjusted returns**.

When it paid to have a high US equity and low bond allocation – and when it did not*

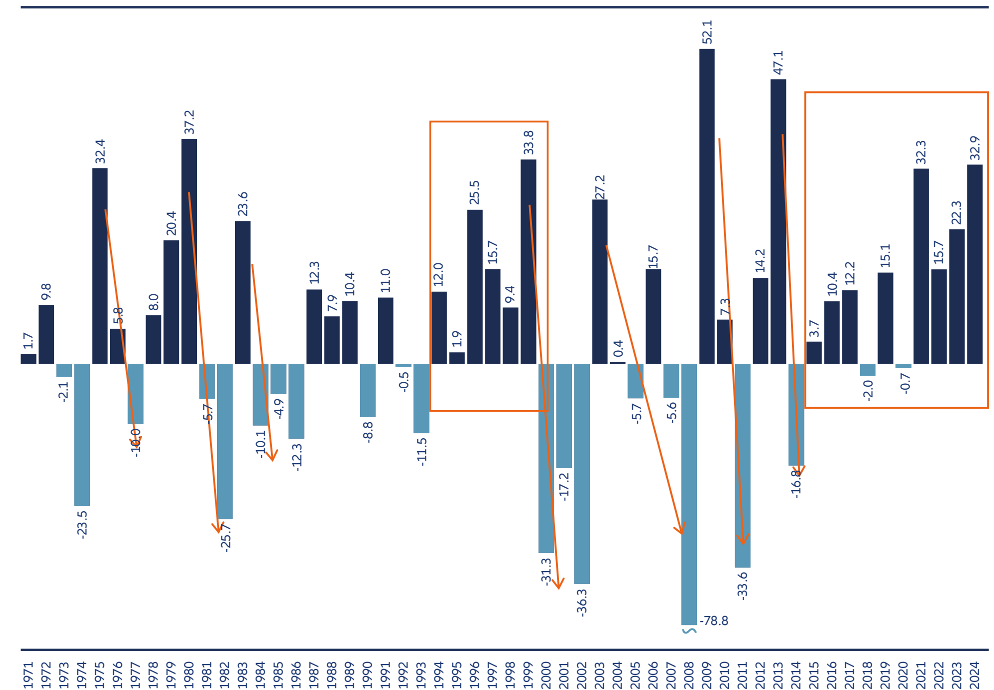

*Chart displays the difference in annual returns produced by the S&P 500 and US 30-year bonds.
Source: Allianz Global Investors’ calculations. Data from Global Financial Data.

→ READ ON FOR MORE DETAILS OF OUR FINDINGS AND WHAT THEY MEAN FOR YOUR PORTFOLIO.

A more active approach to diversification

How did the two portfolio types perform in different macroeconomic scenarios?

We chose four scenarios based on whether economic growth (GDP) and inflation (the consumer price index or CPI) accelerated or decelerated compared with the previous year. Using market data since 1970 we calculated the performance of the portfolios for each scenario.

To reflect both performance and risk, the results are shown as **Sharpe ratios** representing the average annual excess return over US Treasuries divided by the volatility of returns. The higher the number, the better the potential balance of risk and return.

IN THREE OF THE FOUR SCENARIOS, THE DIVERSIFIED PORTFOLIO MATCHED OR OUTPERFORMED THE BARBELL PORTFOLIO.

In a "stagflation" scenario, when GDP decelerates while CPI accelerates, **the barbell portfolio actually incurred a loss while its diversified counterpart achieved a modest gain.**

We also show the results for the individual asset classes.

Performance of the barbell and diversified portfolios, and their constituent assets, across four historical scenarios (1971 to present)

Years in which...	Barbell Portfolio*	Diversified Portfolio*	S&P 500	Equal Weight S&P 500	Developed Equities	EM Equities	10 Year US Bonds	US AAA Corporates	Developed Bonds	EM Bonds	Gold	GSCI Commodities
GDP accelerates & CPI accelerates	0.1	0.6	0.2	0.7	0.4	0.7	-0.3	0.1	1.0	1.3	0.7	0.9
GDP accelerates & CPI decelerates	0.9	0.8	0.9	1.1	0.7	0.4	0.2	0.5	0.2	0.3	-0.4	-0.3
GDP decelerates & CPI decelerates	0.6	0.6	0.4	0.0	0.5	0.2	0.9	1.1	0.5	0.5	0.0	-0.5
GDP decelerates & CPI accelerates	-0.1	0.2	-0.1	0.0	-0.2	0.4	0.2	0.1	-0.3	-0.1	0.7	1.0

Results are shown as Sharpe ratios. Green indicates 0.7 and higher. Red indicates 0 or less.

* The barbell portfolio allocates to US equities, cash and bonds only. The allocations are based on data from the US Federal Reserve Flow of Funds report (June 2024), which gave average US household allocations as 42% equity, 23% bonds, 15% cash and 20% other. In our barbell, we scale up the allocations to US equities, bonds and cash to equal 100%. In the diversified portfolio, the "20% other" from the household allocation is used to incorporate non-US equities, developed and emerging market fixed income, commodities and gold (weights are determined in inverse proportion to the volatility of their returns). The diversified portfolio also replaces the S&P 500 with the equal-weighted S&P 500.

Source: Allianz Global Investors' calculations. Data from Global Financial Data

What does this mean for your portfolio?

Consider spreading your risk

While US equities will likely continue to be a major contributor to shareholder wealth, we anticipate significant volatility ahead. With this in mind – and with bond yields and interest rates normalising – we think investors should consider broader diversification strategies. Within US equity, this might include allocating to the equal-weighted version of the S&P 500 index.

Explore a range of asset classes

Commodities, such as gold, industrial metals and oil, are another way to spread risk in a portfolio. Gold has strengthened its position as a useful tool for diversification and risk management. Where appropriate, some investors may find private markets assets to be a useful diversifier too, with often longer investment horizons and lower correlations to listed stocks.

Diversify globally

As well as investing in a larger share of bonds – both sovereign and corporate – consider more global investments such as emerging market equities (and bonds). Diversifying globally can benefit from a decoupling of economic cycles, which causes global assets to become decorrelated. Growth and policy in the US are set to diverge further from that in Europe and China, for example.

Being diversified can help you stay invested

Several uncertainties could lead to fluctuations in US equities – concerns about AI productivity gains, the impact of US policy, inflation and possible rising interest rates. Long-term performance analysis shows it is essential to stay invested after market declines. Investors should size risk prudently to their risk capacity to capitalise on long-term trends while remaining resilient if those trends shift.

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Breaking the barbell: A return to more active diversification?

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