



THE RIGHT STUFF -

The new wave of asset allocation: how uncorrelated assets aim to protect funds in a crisis

The use of an increasing array of alternative investments with low correlations to other asset classes is on the rise as a way to enhance the risk/return profile for institutional portfolios. But will such portfolios offer greater protection in a time of crisis? And are we really investing in, and benchmarking, the right stuff? GREG BRIGHT reports on the new wave of asset allocation.

It may not have the usual ring of MBA-inspired jargon to it, but Rob Blackwell, Russell Investment Group's expatriate Australian managing director, research and strategy, in Tacoma, Washington, refers to it as "stuff". It's the mix - some may say mishmash - of investments which are difficult or impossible to classify using traditional means.

Following the pioneering work of the large US endowment funds in the 1990s, it has become well accepted, at least by the asset consulting fraternity, that a larger chunk of lowly correlated alternative investments can reduce the risk - as defined by volatility - in a portfolio. But pension funds there and super funds here have been slow to take the plunge into what is a significant departure from how they have approached the asset allocation question in the past. To date, most funds have been content to allocate a smallish percentage - 5 to 10 per cent - of their portfolios to a bucket of alternatives which include the relatively mainstream hedge funds and private equity strategies.

A handful of funds, the most renowned being the Access Economics-advised MTAA Super, have made substantial allocations to less liquid alternatives, such as private equity and infrastructure, to great benefit to their returns. But even these have not adopted the full suite of stuff that Blackwell and others see making up a well-diversified (very well diversified) portfolio of the future. Closer to the mark is probably Australian Reward Investment Alliance (ARIA, formerly PSS/CSS), which over the past four years has diversified across 12 asset "types" including long/short equities, as distinct from absolute returns funds (such as concentrated portfolios), market neutral funds, infrastructure and domestic and international private equity.

ARIA's shift followed a review in 2002, the results of which questioned the three basic tenets of traditional asset allocation for institutional investors: that strategic asset allocation (SAA) is the most important investment decision; that more reward requires more risk; and that investment is a long-term game.

The review found that since the early 1970s there had been very little pay off for taking more risk from traditional SAA.

In a colourful presentation to the Actuaries Institute this year, Andre Morony, ARIA's chief investment officer, showed that a portfolio with "bugger all risk" produced an average annual return of 6.2 per cent in the past five years, while a portfolio which was "as risky as..." produced an average return of only 6.5 per cent. And the difference between the two was similar in previous decades. The lowest risk portfolio had 15 per cent Australian equities and 10 per cent unhedged international equities and 10 per cent property. The highest risk portfolio had 34 per cent Australian equities, 26 per cent unhedged international and 26 per cent hedged international equities and 12 per cent property.

Pay-off for risk in traditional SAA

	Bugger all risk	Bit 'a risk	More risk	Lots 'a risk	As risky as...
1970s	8.8%	9.6%	9.8%	9.4%	9.8%
1980s	16.7%	17.6%	17.6%	17.6%	17.6%
1990s	9.4%	10.4%	10.8%	10.9%	11.0%
2000s to Feb 06	6.2%	6.4%	6.8%	6.2%	6.5%
1971 to Feb 06	10.8%	11.7%	11.8%	11.6%	11.8%

It is clear from the figures that the tenet that more return requires more risk cannot be inverted - the converse that more risk will deliver more return is not always true. It can, at times, hurt.

But a major realisation for the believers in the new-style asset allocation is that having a lot of equities can hurt you more. There have been times when equities went negative and remained so for a long period, the most recent being Japan in the 1990s and into early this decade.

After starting its move to the new-style diversification, funded largely by a big cut in international listed equities from 49 per cent down to 20 per cent, ARIA members were immediately rewarded with a positive 3 per cent return in 2002 against a negative 2 per cent for the average fund that year.

Morony says it is only "sort of true" that SAA is the most important investment decision.

"You can't set and forget," he says. "You're silly if you don't do something about it (make changes) but I don't think you can market time, either."

There is less need to get the timing of strategic shifts right if there is less invested in any particular "bucket".

Similarly, while it is important to invest for the long term, you cannot ignore the short term, Morony says. And the long term is not as long as you think.

For instance, if a member is in a fund for 40 years, the average dollar goes into the account in the 20th year. If you dollar-weight the amount in the account, the average is halved again, to 10 years.

"You're in a world where how long you play the game depends on what happens in the game," Morony says.

ARIA's Strategic Asset Allocation

Asset type	%
Australian equities	26
Australian private equity	4
Int'l developed mkt equities	14
Emerging mkt equities	2
Long/short equity	5
Int'l private equity	4
Property	13
Infrastructure	2
Absolute return	10
Australian bonds	5
Int'l bonds	13
Cash	2

At its last biannual client conference in Melbourne late last year, consultant Watson Wyatt gave a series of presentations which included examples of such diversified portfolios and their likely characteristics. One was designed to protect a super fund from underperforming its peers, as well as offering some absolute downside protection, given that from a business perspective membership retention is more threatened by underperformance than enhanced by outperformance. Interestingly, the audience reaction was that such a portfolio was perhaps more suited to an investment option rather than the main default component of their funds.



Michael Blayney...
'Australian clients more willing to be early adopters'

Michael Blayney, Watson Wyatt senior investment consultant, says that, in practice, investors are making "incremental" changes to their portfolios to include more alternatives, even though small changes will not alter very much the overall distribution of returns.

He says: "They can, and have, added up over time. We have some clients with approximately 20 per cent already invested in alternatives who are looking to increase this further."

"As the allocation to alternatives grows, naturally there is a much larger improvement in the likely distribution of returns, and in the portfolio's ability to perform well in down markets."

"Australian clients ... are probably more willing to be early adopters, but it still takes time."

For funds considering embarking on the new-style strategy, Watson Wyatt provides an example of a portfolio with a spread of equally weighted risks. The more volatile positions, such as Australian equities and private equity, are "penalised" in terms of the capital allocated. The example portfolio's expected return is 8.6 per cent, with a volatility of 7.9 per cent.

Listed equities	Risk weight	Capital allocation
Australian	10%	6.5%
Global: Risk weighted	10%	7.0%
Global: Wealth weighted	10%	7.0%
High yield and emerging market debt	10%	12.0%
Absolute return	10%	20.0%
Commodities	10%	12.0%
Property	10%	20.0%
Private equity	10%	4.5%
Infrastructure	10%	11.0%
Manager alpha	10%	n/a
Expected volatility 7.9%, Expected return 8.6%, Expected information ratio 1.1		

Source: Watson Wyatt



John Nolan ... 'all bets are off if the market is closed'

The main tenet of the new-style asset allocation is that the combination of lowly correlated investments will reduce the overall risk of a portfolio, notwithstanding the risks inherent within each investment.

The main concern, however, is that correlations are not stable. In times of crisis, correlations tend to head towards one.

John Nolan, executive director, investments at Warakirri Asset Management, points out that in such times "all bets are off if the market is closed". Market closes are rare but do occur – New York Stock Exchange after the September 11 terrorist attack and the Hong Kong market after the October 1987 crash.

But even when the market stays open, if buyers withdraw and even brokers are afraid of trading, the market might as well be closed. This was the case for many small-to-medium stocks in Australia for some time after the 1987 crash. Several formerly high-flying funds managers who were overweight the small-medium sector folded, or were sold, not long after, such as ANZCAP, SPAL and Clayton Robard.

Nolan says: "The worst one-day fall on the NYSE up until 1987 was 12.3 per cent. So, if you were building in protection and allowed for, say an 18 per cent one-day fall, and you put your house on it... It's something like a 16 standard deviation event, or one in a million ... Along comes October 19 and the market falls 22.3 per cent on the day."

He believes that in current market conditions there is a significant mispricing of risk because of the relatively benign conditions of the past few years. And there are different types of risk.

Nolan says: "In the late 1970s there was a super fund which had 8 per cent of its Australian equities in Carlton United Breweries (CUB). We did some original research and discovered that the market thought CUB had 150 hotels, but it actually had 250 hotels. They also had a new brewery coming on and owned the house the CEO lived in. The asset relative to the index was a risky position but relative to its absolute value it was very low risk."

The good news about crises, which may throw long-term correlations out the window, is that they tend not to last very long.

This year Russell Investment Group in Sydney created a new unit within its asset consulting arm and appointed Andrew Goddard as director, Alternative Assets and Strategies.



Andrew Goddard ... 'risks that matter are the ones you can't get rid of'

Goddard, who has a background in advising on private equity, opportunistic real estate and infrastructure invest-

ments, says that his position covers "everything that's not standard".

He says the only risks that matter are those you can't get rid of. The big picture risk is all about the long-term economic risks, which an investor cannot do much about.

"What you can do is get rid of a lot of the short-term noise, such as the panic that may follow some stock market movements, a lot of which is from fear and greed," Goddard says. "You can get rid of that with assets which don't get valued frequently or can't be traded."

He admits, however, that some investors may believe that infrequent valuations mean that the low volatility is not "real" and there still may be some "nasty things" going on underneath, or that this is merely an "accounting artefact".

Nolan says, for instance, that the share market is an auction system, which auctions off companies at the margin every day. The price is not typically the transaction price of the asset. But if unlisted assets were auctioned every day, they would have a similar level of volatility. The reduction in volatility for the new-style asset allocation comes from the reduction in its exposure to the markets.

Morony says there is some "artificial stability" in the returns from private equity due to infrequent valuations and the investments would be highly correlated with listed equities if they could be valued every day. But he says there is some benefit to that.

"One of the things which (some) people do wrong is to have volatility as the (only) measure of risk ... We have had some apparently good investments which had low volatility right up until the time they went broke."

If there is a sufficient number of lowly correlated investments in the portfolio the chances of all the correlations going to one are reduced.

"The more diversification the better," Morony says.

Russell's Blackwell admits that correlations are an imperfect way of mathematically representing the sort of diversification now being recommended.

"It's a pretty poor description of reality," he says. "We try to apply a practical overlay, to see what kind of things are likely to happen... If we do have a meltdown, what will happen? At the end of the day no-one really knows. It's an act of judgement."

Consultants and funds which are going down this path are struggling to categorise some of the new types of investments.

Infrastructure, for instance, has both debt and equity components. While it may be an equity investment in the broad sense, it is priced differently on a valuation basis, more like real estate.

How the components of a portfolio are categorised may not concern members if the overall portfolio performs well in both an absolute way – above inflation – and in a relative way – above peers, but it does present a challenge for benchmarking.

ARIA, for instance, has struggled with where to put its market-neutral asset class. The popular Bridgewater All Weather fund, a geared mix of uncorrelated assets including equities and corporate spreads (long corporate bonds and short treasuries) sits in there.

"And where do you put portable alpha, porting global over Australian bonds? What do you call that?" Morony asks. "We decided to just call them bonds."

The years either side of the tech boom proved the catalyst for many funds to rethink their equities exposures. No matter how well diversified, a 60 per cent exposure to equities is risky, says Blackwell.

Part of the due diligence in selecting new uncorrelated investments is to understand what is likely to happen in unusual times of big market movements.



Rob Blackwell ... 'a lot of stuff may include equities'

Blackwell's 'stuff' is not really what we have been calling 'alternatives', although it may include them. It is more "interesting strategies that I cannot categorise in a normal asset allocation".

Blackwell also has difficulty classifying the Bridgewater All Weather Fund, which he likes, as well as Wellington's commodity real return strategy, which he says is really a commodities, raw materials value chain play.

"To me, 'stuff' is about finding a place in a strategic portfolio for strategies I like but cannot fit in under any other category."

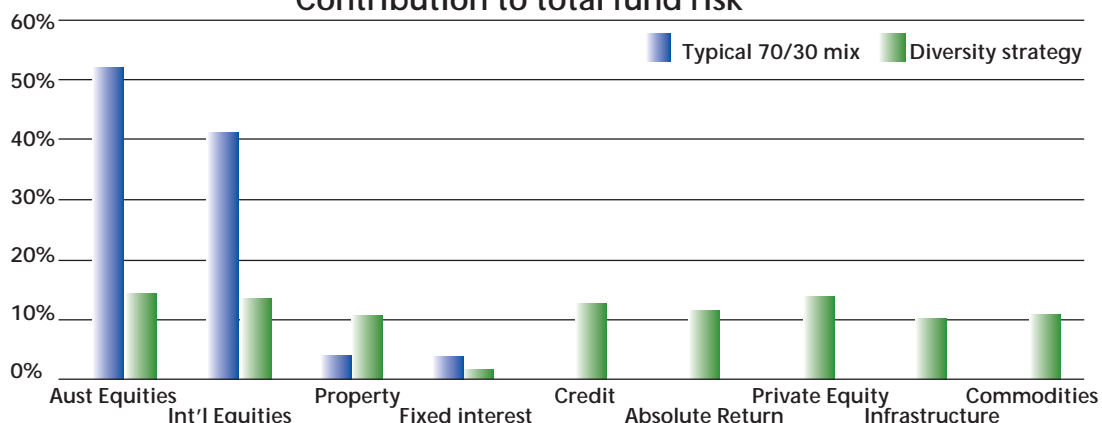
He says he wouldn't be surprised if a lot of 'stuff' in the future includes equities but not in the broad allocations of index-hugging mandates of the past.

An example is a product from West AM which on the surface looks like a 60:40 balanced fund but in reality is more of a commodities real return fund based on the theme of a looming shortage of resources.

The Harvard endowment fund, with its vast array of alternative investments, is the poster child for how big institutional investors should have put together a portfolio in the late 1990s, through the tech boom and bust. A

continued on page20

Contribution to total fund risk





...from page17

crucial element for the endowment, according to Blackwell, is a belief in the strategy which persists despite possibly poor medium-term results.

The new-style portfolio also requires a different way of thinking.

The traditional 70 per cent growth and 30 per cent defensive portfolio is built on the notion that the relationship between risk and return is unchanging, where volatility is believed to be random and the portfolio is systematically rebalanced back to the 70:30 position, according to a Watson Wyatt paper.

A new-style 'diversity' portfolio assumes an unstable environment in which the relationship between risk and return is subject to disruption and in which investors have imperfect knowledge so that the market overshoots and undershoots as it seeks an equilibrium position.

"While this makes problem solving more difficult, we suggest it is a more accurate representation of the real world," Watson Wyatt says.

Michael Blayney says that you cannot think of a range of assets with different correlations as a homogenous group - it's not just one alternatives bucket. And they certainly don't fit into the old "growth" and "defensive" categories. Hedge funds, for instance, can be either. Market neutral funds, which by definition should have a zero correlation with equities, are usually benchmarked against cash.

A lot of alternatives which are currently getting airplay, such as commodities, have always been there. But acceptance of having a higher allocation to them requires a change in mindset.

Alternatives, of course, are more costly and often difficult to access. They invariably involve healthy performance fees on top of the management fee - "2 and 20" (2 per cent management fee and 20 per cent of outperformance) is still common among well-regarded hedge funds. Private equity, which charges similarly high fees, has additional costs associated with drawdown periods.

But many investors are happy to pay performance fees as a better way to align client and manager's interests.

"People mind the 2 more than the 20," says Russell's Goddard.

"The fees are only higher if (the investments) work," says ARIA's Morony. "We think about the after-fee performance as what matters."



Andre Morony ...
*'questioning basic tenets
of traditional asset
allocation'*

And hedge fund and private equity managers are much more likely to be co-investors in the funds they manage than traditional long-only managers and more likely to be staff owned.

Russell's Blackwell says: "I would subscribe to the view that all sources of return deriving from skill are attracting higher fees than we are used to.

"Alternatives are a good example but so are fees on newish active strategies like 120/20 (120 per cent long and 20 per cent short). Anyone with a credible 'investment skill' story seems to be trying to squeeze as much out of the orange as possible.

Simon Ibbetson ... *'fees
are voluntary - you can go
elsewhere'*



"All this puts more responsibility on the investor to ensure that the skill and the reward are there before buying. It has not made the job of managing a retirement plan any easier."

Simon Ibbetson, Standard & Poor's head of asset consulting, puts it an interesting way: "Fees are voluntary," he says. "You don't have to pay them. You can go elsewhere. If you want alpha, then pay the fees ... We always try to get the fees down but if you want skill, particularly where capacity is limited, then you have to pay for it."

One of the issues in discerning likely future correlations is the separation of alpha.

"Some investments may be completely inversely correlated in theory, such as the price of oil and the demand for four-wheel drive vehicles, but they're probably not perfectly (inversely correlated)," Ibbetson says.

"At least they will be negatively correlated. So, we try to achieve negative or even poor correlations, such as the banks versus resources.

"The market goes one way and one asset goes up and another down, but they still have a life of their own. There's some alpha as well. You can also have negative alpha - people tend to forget that."

He observes that the addition of new investments to a portfolio often does not happen at the right time because of the old behavioural finance reasons to do with human nature.

"People are thinking of adding commodities or extra resources now, when we're probably nearing the end of the cycle."

Private equity has been a standout for increasing popularity among the alternatives, but its fit within a strategy of uncorrelated investments is questionable. Notwithstanding the impact of the tech wreck, private equity - with imprecise and infrequent valuations - is often perceived to be only lowly correlated with listed equities.

Russell's Goddard says: "Tech wreck was one of the most dramatic recent events which found its way into everything to a greater or lesser extent... It's a matter of time scale. In the very long run, private equity looks like reasonably good public (listed) investments."

A Russell analysis over 15 years shows that private equity is "essentially a smoothed version of listed equity with more alpha". For Russell's own funds, the extra alpha has been worth it, averaging about 5 percentage points above listed equities.

Patient investors tend to be rewarded, but just how patient can the average super fund board be in a competitive environment?

The Watson Wyatt work for its 'diversity portfolio' identifies two constraints on boards contemplating the approach: the different construction will inevitably lead to periods of substantial underperformance compared with more traditional peers; and uncertainty as to how members will respond to this.

"The 'diversity portfolio' is at a substantial disadvantage when market conditions are favourable for the normal

	Typical "Diversified"	Diversity strategy
Expected return	7.6	7.6
Expected volatility	9.3	6.7
Prob of negative return	21%	12%
Sharpe ratio	0.43	0.60
5th percentile 10 year return (cumulative)	2.9	19.7

portfolio. Given the predominance of equities in a normal portfolio this will essentially be during strong equity bull markets," Watson Wyatt says.

"Equally apparent, however, is the substantial level of outperformance of the diversity portfolio over the normal portfolio during times of weak market conditions.

"Effectively, the 'diversity portfolio' has given up some of the upside to secure the downside."

The consulting firm believes that members will be far more motivated to review their fund and consider alternatives during times of low and negative returns.

"Under this assumption, far from being a risk, we consider that the effect of member backlash during times of distressed markets provides a member recruitment opportunity for the fund with the 'diversity portfolio'."

Given Choice of Fund was introduced only last year, whatever evidence is available of member behaviour in various scenarios is either anecdotal at best or guesswork at worst.

We do know, however, that a high proportion of members (40 per cent from the ASIC case against AMP Financial Planning) who have seen financial planners have switched out of funds which are likely to have provided better historical returns in both absolute and comparative terms.

S&P's Ibbetson, who has a history of advising primarily corporate funds, many of which have outsourced to master trusts, believes that, in reality, the actual time horizon for many members will be just one year.

"The duration issue, where everyone's conscious of performance, will always be a disadvantage to the client (fund). There is so much better return available to the patient investor," he says.

But, going back to where this all started, with the big US university endowments, it cannot be said that competition doesn't weigh them down too. The endowment returns play a big part in providing the services which attract the best students and the best corporate relationships for research.

And maybe it is the big negative years for equities from adopting the traditional approach to asset allocation which would knock their programs around more than some peer underperformance in good years which provides downside protection in bad.

Morony's presentation to the actuaries this year noted that the highest risk fund in his example of traditional SAA would have produced a negative return of 23.3 per cent in 1973, followed by a negative return of 21.7 per cent in 1974 - a difficult pill for any member to swallow.

Apart from peer-group risk, Morony rates the increased exposure to hedge funds and access issues as other constraints for the 'diversity portfolio'.

Under SIS, a super fund cannot borrow, or leverage the whole fund. However, it can, and many now do, invest in funds which themselves are leveraged.

ARIA, for instance, has leverage in some of its property and hedge fund investments, in long/short equities and a bit in Australian equities and global bonds.

A recent presentation by the famous Ron Kahn, who with Richard Grinold wrote the modern classic 'Active Portfolio Management', illustrated the increased efficiency an

investor can achieve through leverage.

Kahn, the global head of advanced equity strategies for Barclays Global Investors, told a seminar organised by ipac in Sydney last month that there was a "natural" level of gearing for every fund for optimum efficiency, depending on the fund's volatility.

"Under-leveraging is worse than over-leveraging," Kahn said.

If a portfolio is not geared or under-geared, in order to increase the level of active risk the managers take bigger bets, meaning that the portfolios become more concentrated. With a long-only constraint, the managers are discarding too much valuable information, the theory shows.

So, gearing is not a problem in theory but the theoretical efficiency of a fund's portfolio is unlikely to persuade a member to take a more patient approach to fund returns.

At the same ipac seminar, David Neal, Watson Wyatt's head of investment consulting, gave his view of the key drivers for funds managers to have for a sustainable competitive advantage over the next five years.

A theme throughout was a better alignment of interests between manager and client. Performance fees represented just one component. Remuneration of staff on a long-term basis was another.

"It's extraordinary how many managers' bonuses are based on one-year figures when their clients have two, three or five-year targets," Neal said. "Capital (International) does its (bonuses) on a four-year basis. I don't know of many who do this."

He said that the active manager of the future would need to adopt either a long-term investing position or have the ability to add value through understanding short-term market psychology. Styles which used shorting and leverage would increasingly dominate the short-term space.

Short-term mandates would involve: multiple strategies providing diversification; high turnover with leverage and shorting; suitability for transporting alpha; and manager skill.



David Neal...
'split between short-term
and long-term mandates'

Long-term portfolios would involve: concentrated portfolios, "which are put away, you don't pay tax on it and you don't measure it monthly"; low turnover; absolute returns focus; and manager skill.

Russell's approach to asset allocation today has also veered well away from traditional growth/defensive categories.

Blackwell says that the consultants think in terms of five main "building blocks" for a portfolio: stocks; bonds; alternatives; opportunistic investments; and alpha.

Already, the "alternatives" category is being complemented by "opportunistic investments".

All good investments involve an element of opportunism. They may include a broad-market stock on which a manager has additional information or one which has clearly over or under-shot fair value.

The blend of real estate and private equity is providing some good examples of opportunistic investments for Russell.

Russell's Goddard says that the type of deal which could be described as "opportunistic real estate" is a theme park development which is a financial flop and is then sold to a hotel chain for redevelopment – changing the structure of the investment as well as the nature of the asset.

Consultants seem to agree that there is no natural cap on the number or range of new investments which may be included in a new-style asset allocation.

But the investments still have to pass the tests as to

whether they represent good investments. It will help longer term if the managers which offer them are able to demonstrate skill and are able to point to robust and relevant benchmarks.

While a myth surrounding private equity may be its low correlation with listed equities, similarly there may be a misrepresentation by hedge funds of a good chunk of beta dressed up as their own alpha.

Many long/short funds, for instance, do not have the controls in place to prevent a natural skew to short large caps, especially the banks, and go long medium-to-small caps.

A good portion of commodities futures funds, too, will reflect the underlying beta of the commodities markets along with a reflection of the bond markets in their handling of collateral.

If John Nolan is right, and overall market conditions during the past five years have led to a level of complacency about risks across a whole spectrum of investments, new-style asset allocation, and those who have gone down the path to introduce it, may be tested.

Nolan says that the risk premium for non-investment grade bonds is historically about 7 per cent. Now, because times have been good, the margin is down to about 3.5 per cent.

Similarly, secondary property would typically trade at 100bps above the prime rate, but this has closed down to 50bps in the past five years.

In striving for yield, investors may be degrading the credit quality of the portfolio.

Another example which may prompt you to question your approach to risk: in the mid-1990s the banks made up about 12 per cent of the Australian listed equity market; now it's 25 per cent. But the banks consist of about 7 per cent capital and 93 per cent debt.

"Banks are risky," Nolan says. "If they weren't there wouldn't be so much supervision of them." ■

With correlations, look at the fundamental drivers



One global manager which is a believer in the new style of asset allocation and has put its principles into practice through a fund, the All Weather Fund, is Bridgewater Associates.

In a recent note to clients, Bridgewater looked at correlations in the two biggest asset classes and concluded that to predict future correlations investors should study the fundamental drivers of returns.

Bridgewater says: "It's been about eight years since the typical positive correlation between stocks and bonds has gone away. After being about 40 per cent correlated in the 10 years prior to the Asian crisis (the highest correlation in decades), stocks and bonds often have been strongly negatively correlated since then, and more recently they have been uncorrelated.

"Correlation can best be understood by first thinking about the fundamental drivers of each asset class separately, rather than relating it to asset performance

directly. For example, the pricing of bonds reflects, among other things, expectations of future inflation. Likewise, the stock market is affected by actual and expected inflation.

"Both stocks and bonds benefit from falling inflation and are hurt by rising inflation. Therefore, if inflation is a dominant influence on returns, we can expect a positive correlation between stocks and bonds. But if inflation does not move, the assets may be negatively correlated or uncorrelated, depending on how each of them relates to other drivers, such as economic growth.

"Stocks and bonds are impacted in the opposite direction by economic growth; falling growth hurts stocks and helps bonds. Therefore, if economic growth is the dominant influence on returns, stocks and bonds will be negatively correlated.

"The reason why stocks and bonds have been negatively correlated in recent years is because inflation has been very stable, while growth has been much more volatile.

"So, instead of relying on recent history, a better approach is to think about the asset classes' drivers. Will inflation continue to be a non-issue while growth remains relatively volatile? While we can't

know for sure, we think there are good reasons to be more uncertain about inflation going forward with implications that include, but go beyond, asset price correlations...

"Correlations of assets to one another are a statistical by-product of the true underlying relationship of assets to the economic environment and the nature of that environment.

"While economic growth has been volatile, earnings (the more direct and relevant driver for equities) have been even more volatile in recent years..."

The chart shows the correlations of stocks to bonds against the relative volatility of interest rates to earnings (on a rolling five-year basis). This demonstrates how correlations can be understood in terms of the volatility of the drivers of the different asset classes.

Bridgewater says that, as of early August, it is short both equities and bonds, although its view on bonds is significantly stronger.

"We are now at the stage of the business cycle where stronger-than-expected growth (or even moderate growth) will produce higher inflation. Therefore, going forward, strong growth will no longer be an unmitigated positive for equities. This environment is more clearly bearish for bonds. Without an increase in yields, we expect both healthy growth and rising inflation. This in turn will pressure yields higher."