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Death of the 60/40 portfolio

Brian Spinelli and the team at Halbert Hargrove read the tea leaves and moved their clients into alternatives and real assets

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By Mike Consol

Halbert Hargrove by the Numbers

Year founded
1933

Assets under management
$2.3 billion

Clients
600 families and institutions in 38 states

Average client net worth
$3 million to $4 million

Personnel
43 employees

Average experience
15 years

Employee retention
Five-year average of 95 percent

Client retention
55 percent have been with firm for five years or more

Offices
Eight: Long Beach (headquarters), Bellevue, Wash.; Costa Mesa, Calif.; Denver; Houston; San Diego; Scottsdale; The Woodlands, Tex.

| Halbert Hargrove CEO Russ Hill with Brian Spinelli.

Death of the traditional 60/40 portfolio

Brian Spinelli and the team at Halbert Hargrove read the tea leaves and moved their clients into alternatives and real assets

During second quarter 2017, Brian Spinelli and other members of the Halbert Hargrove executive team officially declared the traditional 60/40 portfolio "dead" in their quarterly market view report. The report, specifically titled *The Death of 60/40*, reasoned that two-dimension stock-and-bond portfolios are not going to deliver the returns required for the firm's clients to build a retirement-scale garrison of assets, let alone one that serves more ambitious financial goals, such as philanthropic pursuits or paying college tuition for grandchildren and great-grandchildren.

Spinelli concedes, without any prompting, the report's title was somewhat overstated, even sensationalized, to ensure clients would read the paper and better understand changes being made to their portfolios to give them diversification and better long-term performance. Indeed, those changes were put in motion about five years before the firm wrote the paper sounding the death knell. Put simply, Halbert Hargrove moved into the alternatives and real assets space to give portfolios a richer blend of asset classes, while still including a significant share of equities and bonds. In reality, Spinelli says, rather than having suffered an eternal death, the 60/40 has gone into hibernation for the foreseeable future.

Russ Hill, the firm's CEO, explains: "Instead of thinking about stocks and bonds in a traditional sense, we really started looking at what you might call 'growth assets' versus 'risk-reducing' or 'diversifying assets.' We realized that the tailwind behind owning fixed income was certainly weakened. At the very least, we knew the fixed-income portion, the bond portion, was unlikely to perform the way it has in the past — and it might actually be a negative return — at the same time that stocks were pretty fully priced."

Spinelli adds: "What we started seeing is that fixed-income return expectations over the next 10 years looked to be about 3 percent, and that is not even taking into account that you may have interest-rate adjustments. That pushed us to look at other things."

Even as those calculations were being made by Spinelli and Hill, regulators and the custodians were allowing more alternatives in pooled '40 Act investment funds, and available technology continued improving the firm's ability to track and price a wider array of assets classes, they explain.

While fixed income is certainly *not* down for the count forevermore, Spinelli does not foresee a day when HH (as even members of the firm abbreviate the Halbert Hargrove name) would return to a portfolio comprising only stocks and bonds.

Spinelli, as chairman of the HH investment committee, played a leading role in the move from 60/40 to alternative and real asset diversification.

"Brian is highly organized and very analytical," Hill says, "and he also has good people skills — a combination that is not all that common. So, in that role, he has largely replaced me, which is good because he is actually better at it than I was."

Hill continues in the role of CEO, while Spinelli appears his likely heir apparent on the investment committee.

> *"In reality, rather than having suffered an eternal death, the 60/40 has gone into hibernation for the foreseeable future."*

THE NON-60/40 FORMULA

So what, more specifically, are the new non-60/40 portfolios designed by Spinelli and company composed of? In broad asset-class terms, the average portfolio still, more or less, is about 60 percent stocks — 50 percent committed to international stocks; about 35 percent U.S. stocks, including a component of publicly traded real estate shares; and about 15 percent to emerging-market stocks. The firm favors an indexed low-cost approach to equities, mainly using the Russell 1000 Index and the Russell 2000 Index for domestic large- and small-cap equities, respectively. For international shares, it primarily uses the MSCI EAFE Index, which is designed to represent the performance of large- and mid-cap securities across 21 developed markets.

The alternatives and real assets slice of the portfolio averages a robust 20 percent of overall assets, with sights set on moving to an average of 25 percent over time, reserving 15 percent to 20 percent of the average portfolio for bonds or other fixed-income instruments.

"I would say the alternatives portion of the portfolio is abnormally high for our environment, meaning a lot of people have not moved that far out," Spinelli says.

Alternatives in the portfolios include a real estate interval fund structure that replicates the NCREIF Fund Index – Open End Diversified Core Equity, as well as alternative lending (mainly using alternative lending platforms to access small business loans), reinsurance, variance risk premium and managed futures — offering a differentiated source of return under times of market stress or crisis.

"We will be willing to deviate. The underlying character of how we are doing alternatives today will change," says Spinelli. "For example, it may not make sense to always have alternative lending in a portfolio, and the reason being is that at some point, the return streams there may get overbought."

FROM OIL LEASES TO RIA

Though based in Long Beach, Calif., the 85-year-old firm now has clients in most states, in part because of the mobility of the U.S. population, as well as the firm's expansion into wealthy markets such as Denver; Houston; San Diego; Scottsdale, Ariz.; and Bellevue, Wash., where offices have been opened.

Halbert Hargrove was founded by namesake partners John Halbert and Leonard Hargrove in 1933, in the midst of the Great Depression. The founders made their fortunes from oil leases in the Southern California boomtown of Signal Hill and decided to start an investment firm, initially by investing their own money. A third partner, Mortimer White, departed shortly after helping found the firm to manage five small family banks in Montana. Hargrove died in 1955 and Halbert in 1974. Russ Hill bought HH in 1976 and managed to grow the firm to its current assets under management of $2.3 billion, on the strength of 600 individual, family and institutional clients located in 38 states.

Individuals and married couples account for 80 percent of the HH client base, with an average age in their late 50s or early 60s.

Some investors used to abide by an adage that the percent of bonds in your portfolio should be equal to your age — meaning a

GETTING PERSONAL
Brian Spinelli

If you could go back in time, what would you tell a 25-year-old Brian Spinelli?
Spend some time enjoying the moment. The future is important, but it's not everything.

How do you like to spend your time outside of work?
I love being outdoors and being with my family. I am not one to like to sit idle indoors.

First choice for a new career?
Teaching basic personal finance to entry-level undergrads. Some of my greatest joy in this job is taking the confusion out of things for clients.

Most influential book you have read?
The Hedge Fund Mirage by Simon Lack.

What are you afraid of?
Failure

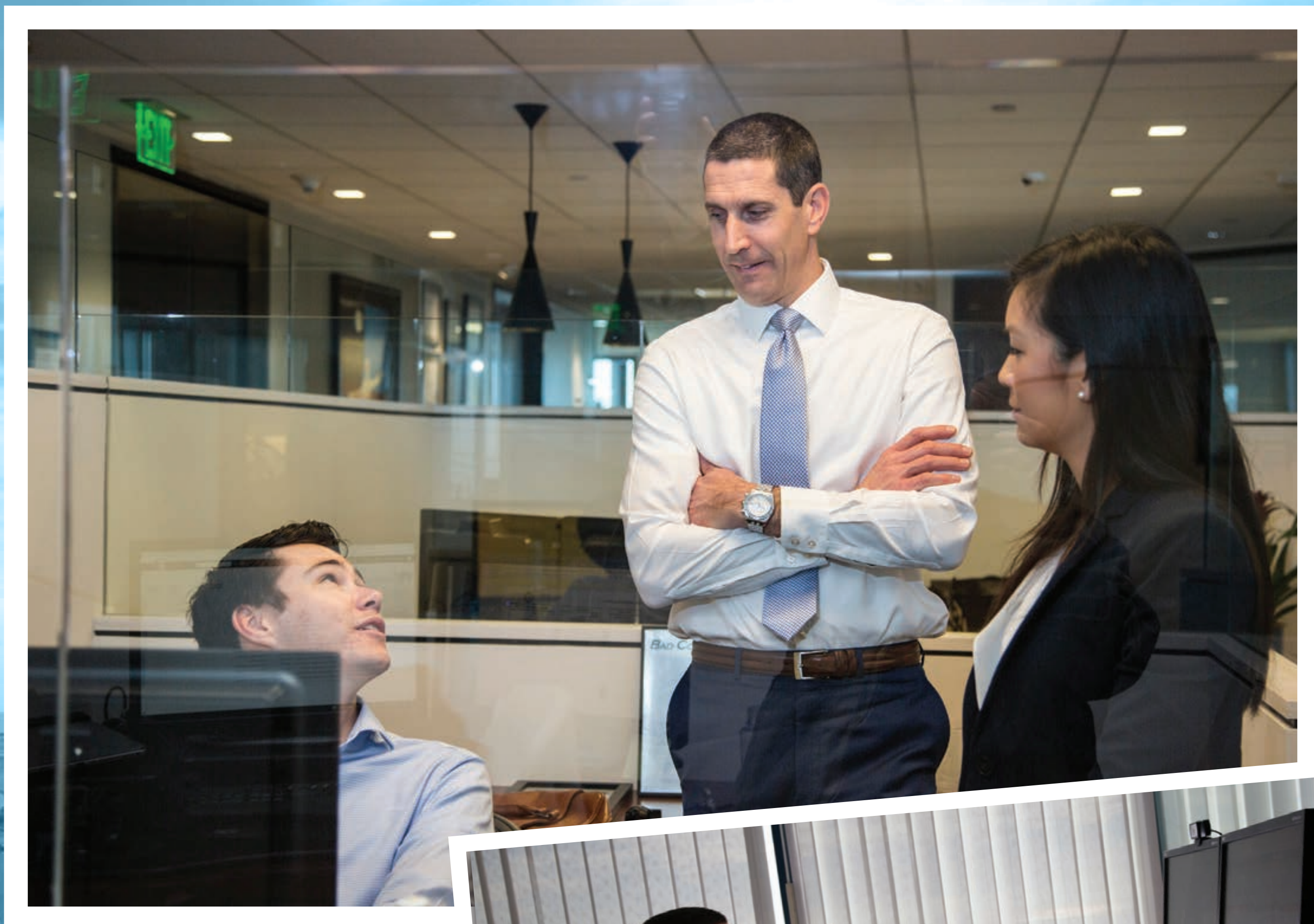
Biggest lesson you've learned?
Be humble in life, and you can't control everything

Best piece of career advice you ever received?
Find your passion and pursue it. If you are going to work for 40-plus years, do something you love.

What phrase is most overused in your industry?
Pick any sports analogy to markets and investing. I understand they can be helpful to some, but you better know your audience before just saying them.

How do you want to be remembered?
As a good husband, father and friend — as well as someone who worked hard to earn his success.

"Brian is highly organized and very analytical, and he also has good people skills – a combination that is not all that common."



60-year-old would have a portfolio with 60 percent fixed income.

"You can see fixed-income rates of return going forward, and they really won't take clients where they need to go, with returns that might fall below inflation over the next decade," Spinelli says, which is exactly why the firm's brain trust has abandoned the stocks-and-bonds-only portfolios in favor of a broader, more diverse mix of assets.

PLAYING DEFENSE

While earning his bachelor's degree in business administration at Loyola Marymount University in Los Angeles, Spinelli had no inkling of a career in the wealth advisory business, nor when he returned to Loyola to earn his MBA in finance, though he was working with numbers as a financial analyst at Northrop Grumman Corp., one of the country's major defense contractors. That role entailed calculating financial projections, market and portfolio analysis, and financial modeling for a company renowned for the stealth technology it incorporated into advanced bombers designed and manufactured for the U.S. military. Spinelli reported to the CFO and director of financial planning.

From time to time, Spinelli's colleagues at Northrop Grumman would approach him about which choices they should make in their 401(k) plans; one person even suggested Spinelli should be doing financial advisement for a living. It was not until his parents were ready to retire that Spinelli was set on the path to a wealth advisory firm. His parents sought the assistance of a neighbor who worked as a CPA, and he suggested they visit Halbert Hargrove. While Spinelli oversaw the interaction between his parents and their HH adviser, it became apparent the junior Spinelli had an interest in making a career move into the private wealth business. When a position came open, Spinelli received a call from J.C. Abusaid, the firm's president and COO, suggesting he interview for the job.

"I said, 'Absolutely,'" he recalls. "Slowly but surely I worked my way into that level over time."

It was 2006 when Spinelli made the move to HH, right before the global financial crisis sent shockwaves through all things monetary.

"What really pushed me into where I am today was how I dealt with that period of time and with the people I represented," he says. "It was really difficult, but we did a good job of managing clients, and getting them to stay the course and not do things that would permanently harm themselves. As hard as it was going through that, I look back and see it as the pivotal moment when I realized I could succeed in the advisory business."

In time, Spinelli climbed the executive ladder and, in addition to serving as chairman of the investment committee, is one of the people who helps set the vision for the firm's future, though he identifies Hill as chief visionary. Currently, that vision revolves largely around "longevity," as in keeping advisers and clients focused on a long-term orientation. The time horizon is shifting, Spinelli observes, as lifespans increase, and retirement is sometimes forestalled because people's health and vigor make elongated careers practical and even desirable.

> *"At this stage, inorganic growth through acquisitions is hard to stomach because of high M&A valuations and the cultural conflicts that often have to be overcome."*

"The overarching agenda item at this point is to make sure people understand how this is going to be impacting them — and that doesn't just mean their money, it means everything from healthcare options to understanding how they are going to be eventually liquidating their homes and changing their communities," Spinelli says.

That long-term orientation Spinelli and his colleagues try to instill is often situational for clients. "When things are going well, they will be long-term investors," he says. "When things are going poorly, they will tend to be behaviorally short-term investors. But I have to commend a majority of our client base because they have been very stable."

Succession planning among the firm's leadership is another major initiative being pursued at HH. Hill indicates experience has taught him many firms either overlook succession planning or do an incomplete job of putting a plan into place.

"We have been working intensively the last five or six years to move people like Brian, for example, on the wealth advisory side, and other young people on the compliance, marketing and technology sides with 10 to 12 years of experience, into the position of shareholders," Hill explains.

INTO THE FUNNEL

To date, the firm's growth has been strictly organic, though Spinelli says HH has and will continue to consider nonorganic growth via acquisition.

Hill adds, however, at this stage, inorganic growth through acquisitions is hard to stomach because of high M&A valuations and the cultural conflicts that often have to be overcome.

"If we could just keep doing between 10 percent and 15 percent a year, not including the market, we will be just fine," he surmises.

The firm's organic growth has come primarily from two sources: client referrals, and advisers in their 30s and 40s who have achieved traction in terms of growing their client base.

"The other part, for us, is technology and workflow-based," says Hill. "We can bring in an account, put it online and operate it almost untouched by human hands, unless the client needs to talk to somebody on a planning issue."

The firm has also launched social media and public relations outreach programs, with an aim toward driving more traffic into its "sales funnel."

"Once we get them there," says Hill, "we are pretty good at converting them to clients." ■

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