

3 Strategies for Volatility

When markets become challenged, diversification can enhance portfolio resilience.

US equities, as measured by the S&P 500 Index, compounded at a remarkable average annual rate of 13.5% from 2009 to 2024.¹ Investors who eschewed diversification in favor of US equities saw their portfolios handily outperform more diversified portfolios—until now.

The long-awaited broadening of returns beyond US large-cap equities began before President Donald Trump’s historic tariff announcement on April 2 sparked a significant uptick in volatility, and there are compelling reasons why this trend could continue going forward.

Risk-conscious investors may want to consider three strategies: diversifying with fixed income, reallocating to international equities, and incorporating dividend-paying stocks.

1. Diversifying With Fixed Income

Even after the dramatic sell-off in the wake of Trump’s tariff announcement, US equities are still trading at a premium valuation on a forward-looking basis.² Valuations have fallen, but still seem to be pricing in a swift resolution of trade disputes and continued optimism about artificial intelligence.

One way to measure the relative value of stocks vs. bonds is with the earnings yield, which measures the S&P 500 Index’s most recent 12-month earnings divided by its current market price. The yield on the 10-year US Treasury recently surpassed the S&P 500 Index’s earnings yield (FIGURE 1). This may indicate that bonds are currently a better value than stocks.

Key Points

- Fixed income offers attractive yields and lower drawdowns compared to equities, making it a valuable component in a diversified portfolio.
- International equities can help reduce concentration risk and could benefit from a weaker US dollar.
- Dividend-paying stocks can provide a reliable income stream and can significantly contribute to total returns, especially during periods when market returns are lower.

FIGURE 1: Bonds May Be Undervalued Relative to Stocks

S&P 500 Index Earnings Yield and 10-Year Treasury Yield (%)



Chart Data: 4/28/95-3/31/25. **Past performance does not guarantee future results.** Indices are unmanaged and not available for direct investment. Please see last page for index definitions. Data Sources: FactSet and Hartford Funds, 4/25.

After trading at a premium from 2018 until early 2022, the average price of bonds in the Bloomberg US Aggregate Bond Index (the Agg) has been trading at a discount (FIGURE 2). This fact, coupled with the potential for rate cuts by the Federal Reserve (Fed), could mean attractive total return for bonds going forward.

FIGURE 2: The Average Bond Is Trading at a Discount

Average Bond Price of the Bloomberg US Aggregate Bond Index

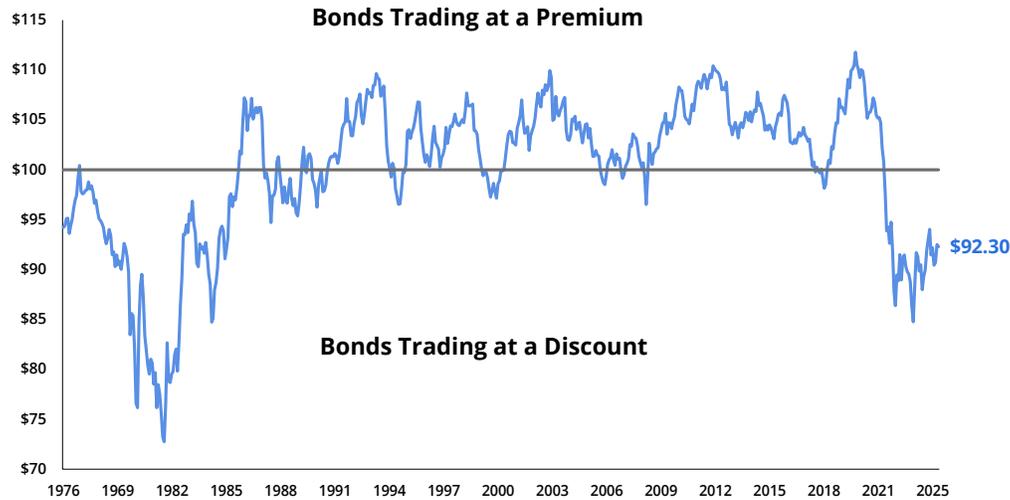


Chart Data: 1/30/76-3/31/25. Past performance does not guarantee future results. A bond is trading at a premium when the current price is higher than its face value. A bond is trading at a discount when the current price is less than its face value. Data Source: Bloomberg, 4/25.

Another compelling argument for bonds is their attractive yields. The best predictor of future bond returns has historically been their current yield. When you overlay the ending yield of the Agg with its 10-year rolling returns, the strong correlation between yield and return is striking (FIGURE 3).

FIGURE 3: Bond Yields Suggest Potentially Attractive Forward Returns

Bloomberg US Aggregate Bond Index Yield to Worst and Rolling 10-Year Returns

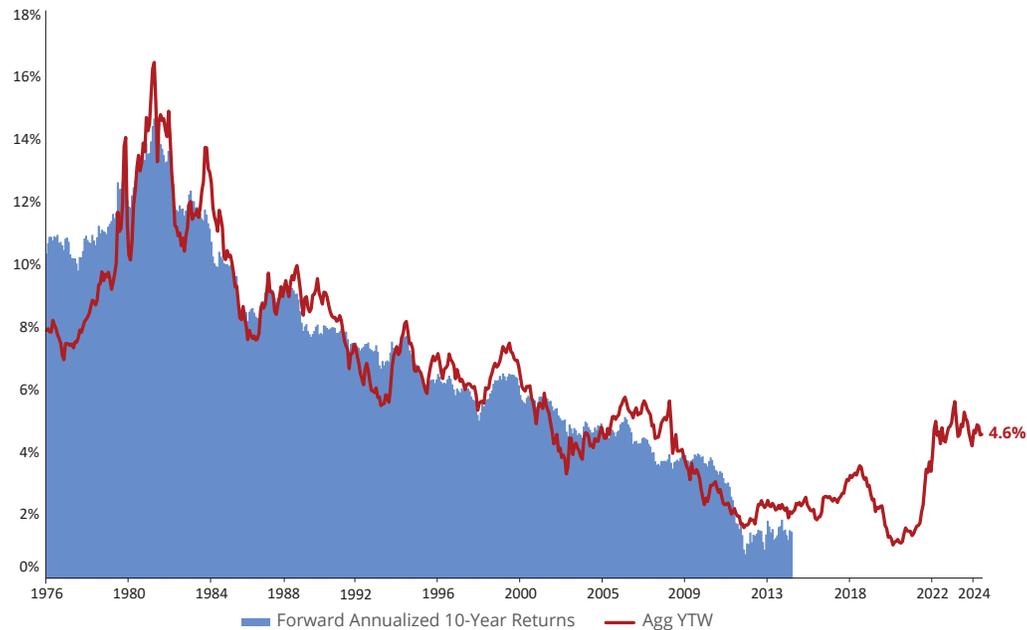


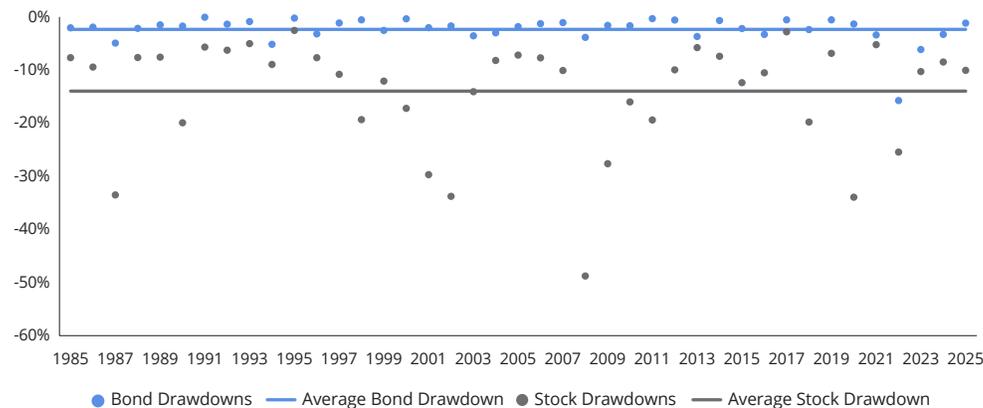
Chart Data: 1/31/76-3/31/25. Past performance does not guarantee future results. Yield to worst (YTW) is the minimum yield that can be received on a bond assuming the issuer doesn't default on any of its payments. Data Sources: Bloomberg, Morningstar, and Hartford Funds, 4/25.

Fixed Income Has Experienced Significantly Lower Drawdowns

One of the main reasons for owning bonds is to hedge against equity volatility in a portfolio. Since 1985, bonds have averaged a maximum average annual loss of -2.3% vs. a -14.0% maximum average annual loss for stocks (FIGURE 4).

FIGURE 4: The Maximum Annual Loss for Bonds Is Significantly Lower Than for Stocks

S&P 500 Index vs. Bloomberg US Aggregate Bond Index: Intra-Year Max Drawdowns



Bonds have experienced significantly lower maximum annual drawdowns than stocks during periods of market stress.

Chart Data: 1985-3/31/25. **Past performance does not guarantee future results.** Drawdowns refers to the largest drop from peak to trough in performance during the calendar year. Bonds are represented by the Bloomberg US Aggregate Bond Index. Stocks are represented by the S&P 500 Index. Data Sources: Morningstar and Hartford Funds, 4/25.

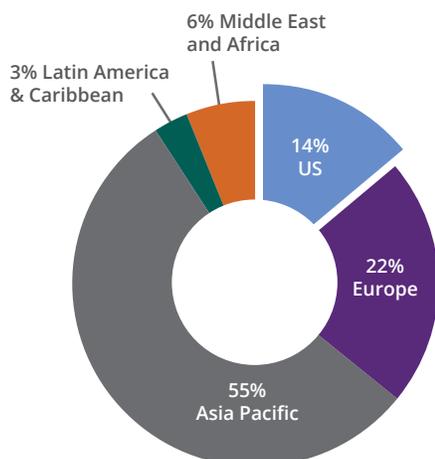
2. Reallocating to International Equities

US large-cap equities performed so well in the aftermath of the Global Financial Crisis that they were often the best-performing asset class over the past 15 years—significantly outperforming diversified portfolios. This led some market commentators to declare that we’ve been in “a bear market for diversification.”³

There are good reasons why US equities should be the cornerstone of investor portfolios: The US has a unique mix of highly innovative companies, high liquidity, and a business-friendly regulatory environment. Nevertheless, prudent risk management suggests that overlooking most of the world’s companies may not be wise (FIGURE 5). Many investors are surprised to discover that *most* of the best-performing stocks each year are based outside the US (FIGURE 6).

FIGURE 5: US Companies Make Up Just 14% of All Global Public Companies

Global Percentage of Publicly Listed Companies by Region



As of 3/31/25. Data Source: Bloomberg, 4/25.

FIGURE 6: Most of the Best-Performing Companies Each Year Are Outside the US

Percentage of the World’s Top 50 Stocks That Are Non-US

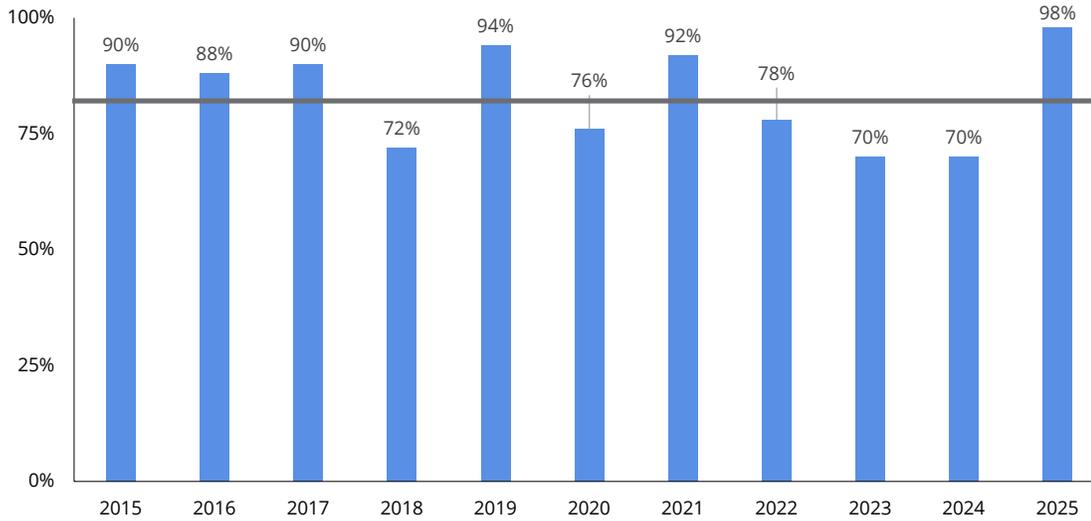


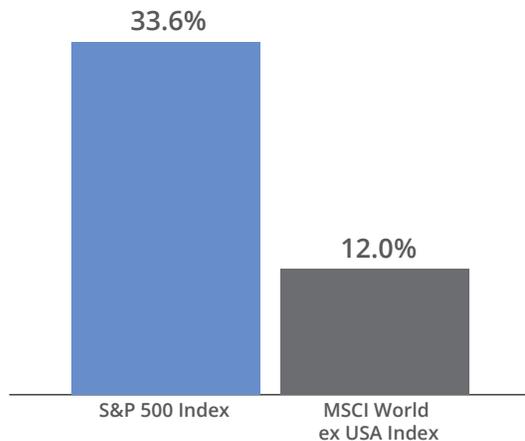
Chart Data: 2015-3/31/25. Past performance does not guarantee future results. Based on the annual calendar year returns of 50 highest-performing stocks of the MSCI ACWI Index. Please see last page for index definitions. Data Sources: Factset and Hartford Funds, 4/25.

International Equities Are Less Concentrated and More Diversified by Sector

The concentration risk in many US large-cap portfolios has received a great deal of attention in recent years—and with good reason. Concentrated portfolios benefit investors when the largest holdings in the portfolio perform well, but they can significantly harm investors when they perform poorly. The S&P 500 Index, which is the basis for many of the largest mutual funds and ETFs in retirement plans and IRAs, has much more concentration risk than a comparable international index (FIGURE 7).

FIGURE 7: The S&P 500 Index Is Nearly Three Times More Concentrated in its Top Holdings Than a Comparable International Index

Top 10 Holdings Concentration: S&P 500 Index vs. MSCI World ex USA Index

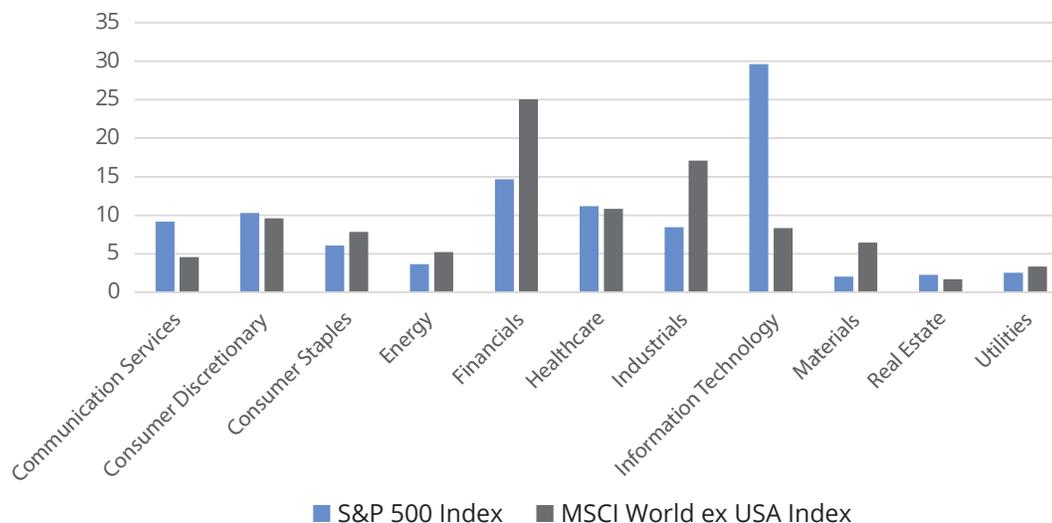


As of 3/31/25. Please see last page for index definitions. Data Sources: FactSet and Hartford Funds, 4/25.

In addition to concentration by holdings, the S&P 500 Index is also significantly more concentrated by sector than a representative international index (**FIGURE 8**). The S&P 500 Index has a 30% weighting in technology, but this figure doesn't take into account tech-oriented companies such as Amazon, Meta, Alphabet, and Tesla that are classified in different sectors. Including those types of companies pushes the technology and tech-adjacent allocation to approximately 40%.

FIGURE 8: The S&P 500 Index Is Much More Concentrated by Sector Than Than a Comparable International Index

Sector Allocations (%): S&P 500 Index vs. MSCI World ex USA Index



As of 3/31/25. Source: FactSet, 4/25.

The End of Globalization?

Trump's tariffs are causing foreign countries to reexamine their supply chains to increase domestic production. This trend began during the COVID-19 pandemic, but the tariffs seem to be accelerating it. For example, Japan is increasing domestic production and sourcing from Southeast Asia to avoid tariffs and reduce reliance on Chinese manufacturing.⁴

Countries in the European Union are diversifying their supply chains by sourcing from within the bloc or neighboring countries to reduce dependence on imports from tariff-affected regions.⁵ India is boosting its "Make in India" initiative, encouraging local manufacturing and reducing imports by providing incentives to domestic producers.⁶ Canadian businesses are looking to source more materials domestically to avoid tariffs on imports from other regions.⁷

John Butler, a macro strategist at Wellington Management, thinks the tariffs could ultimately result in a rebalancing of capital flows away from the US.⁸ Butler says there are five main reasons to invest in the US—growth, return, liquidity, relative safety, and credibility—but that tariffs could change how international investors think about what the US has to offer.⁸

If investors conclude the US is likely to offer less growth, less return, and less safety going forward, Butler says we could see a structural reversal of capital flows to the detriment of the US, which would also translate into a lower dollar and a higher risk premium.^{8,9} A lower dollar would be a significant tailwind for international equities.



Tariffs could change how international investors think about what the US has to offer.

Nanette Abuhoff Jacobson, global investment strategist for Hartford Funds, shares more potential implications: “We could also see relative outperformance of European equities, given European policymaker efforts to ramp up structural spending in areas such as defense, infrastructure, and digitization. This could also be a catalyst for European policymakers to accelerate their competitiveness and economic policy agenda, as outlined in the Draghi report.”^{10,11}

Allocating to International Equities

When it comes to international-equity allocations, there’s no one-size-fits-all allocation that’s right for every investor. **FIGURE 9** shows how allocating different amounts of international equities into a portfolio can affect potential risk and returns within a portfolio.

FIGURE 9: The Risk/Reward Trade-off of International-Equity Allocations
Return (%) and Standard Deviation (%) by Equity Allocation Breakdown

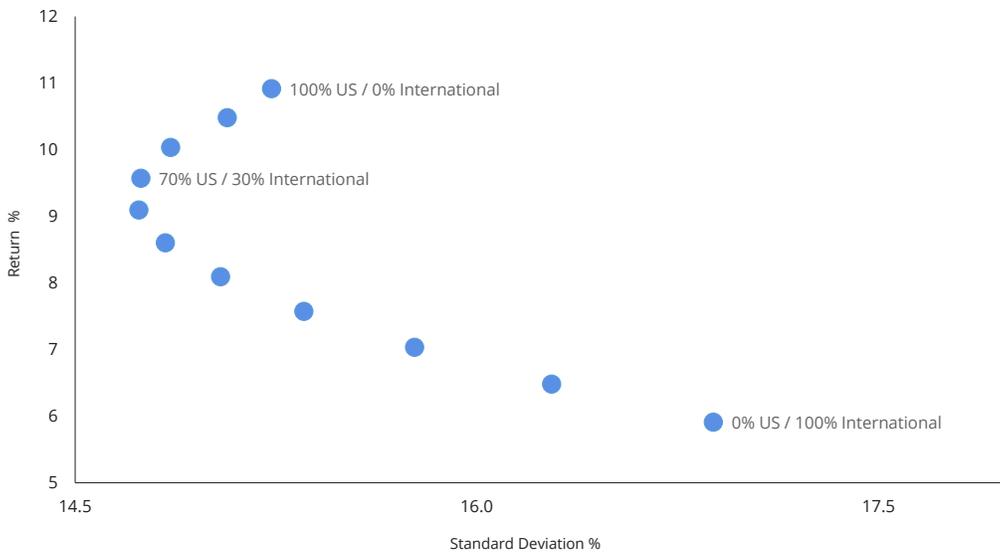


Chart Data: 1987-3/31/25. **Past performance does not guarantee future results.** International stocks are represented by MSCI EAFE Index. US stocks are represented by the S&P 500 Index. Please see the last page for index definitions. Standard deviation measures a portfolio’s total-return volatility. A higher standard deviation indicates higher historical volatility. Data Sources: Morningstar and Hartford Funds, 4/25.

3. Incorporating Dividend-Paying Stocks

During periods of uncertainty, investors are typically more concerned with fundamentals such as earnings growth, consistent cash flows, and quality management teams than market narratives and promises of future growth. That’s why many investors turn to dividend-paying stocks during times of market stress—because dividends can be an excellent sign of a financially sound company.

Many market forecasters expect the stock markets’ returns to be less generous over the next decade than they’ve been over the past decade. If so, dividends could grow in importance: In previous decades in which stock returns were in single digits, dividends played a much larger role in overall returns (**FIGURE 10**).

FIGURE 10: Dividends' Contribution to Total Return Has Been Larger When Returns Were Lower

S&P 500 Index Annualized Total Return by Decade (%)

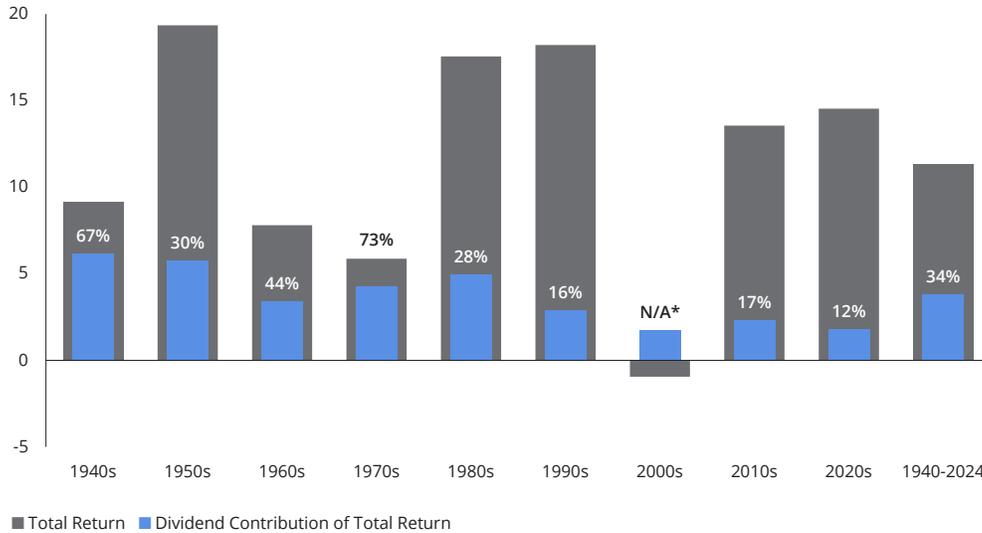


Chart Data: 1940-2024. **Past performance does not guarantee future results.** Indices are unmanaged and not available for direct investment. *Total return for the S&P 500 Index was negative for the 2000s, but dividends provided a 1.8% annualized return over the decade. For illustrative purposes only. Data Sources: Morningstar and Hartford Funds, 3/25.

A study by Ned Davis Research compared the dividend policies of stocks in the S&P 500 Index. They found that companies that either grew or initiated a dividend significantly outperformed companies that kept their dividends stable or non-dividend payers—and they did so with significantly less volatility (FIGURE 11).

FIGURE 11: Dividend Growers and Initiators Performed the Best With the Least Volatility

Return and Risk of S&P 500 Stocks by Dividend Policy

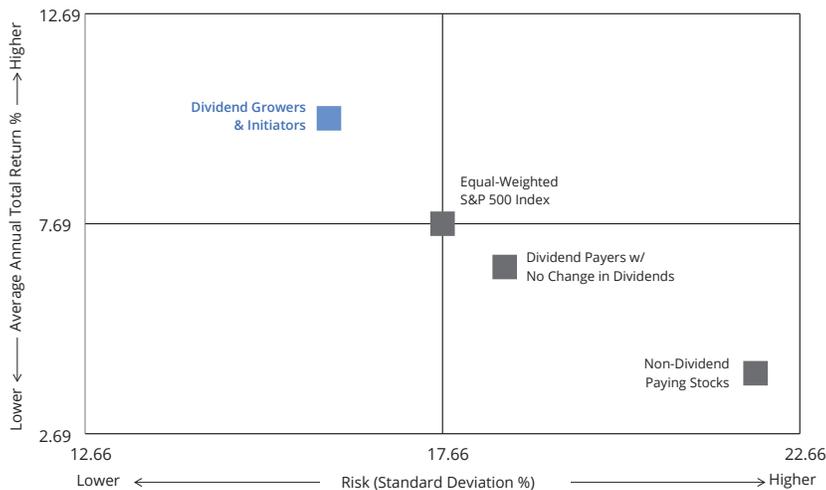


Chart Data: 1973-3/31/25. **Past performance does not guarantee future results.** Ned Davis Research conducted a study in which they divided companies into two groups based on whether they paid a dividend during the previous 12 months: dividend-paying stocks or non-dividend paying stocks. The dividend-paying stocks were then divided into groups based on their dividend payout behavior during the previous 12 months. Dividend Growers and Initiators include stocks that increased their dividend anytime in the last 12 months. Once an increase occurs, it remains classified as a grower for 12 months or until another change in dividend policy. Dividend Payers with No Change in Dividends include stocks that maintained their existing indicated annual dividend for the last 12 months. Data Sources: Ned Davis Research and Hartford Funds, 4/25.

“ Companies that grew or initiated a dividend significantly outperformed companies with stable or no dividends. ”

Dividend-Paying Companies Come From a Variety of Industries

When people think of what types of companies typically pay dividends, their minds may immediately go to sectors such as utilities and energy that have been a staple of dividend income for decades. But the types of companies that pay dividends have evolved over time. As companies mature and their growth rate stabilizes, many decide to return a portion of their capital to shareholders through dividends.

For example, Microsoft was one of the best growth names of the 1990s, and it began paying a dividend in 2003. Apple resumed dividend payments in 2012 after a long hiatus. Likewise, Nvidia first began paying a dividend in 2012. **FIGURE 12** shows the dividend yield for each sector within the S&P 500 Index and the highest-yielding company within each sector.

FIGURE 12: Energy, Utilities, and Real Estate Have the Highest Yields

S&P 500 Index Sector Dividend Yields and Highest-Yielding Companies

S&P 500 Index Sector	Sector Dividend Yield (%)	Highest-Yielding Company in the Sector
Real Estate	3.3	Crown Castle Inc.
Energy	3.1	APA Corporation
Utilities	2.9	AES Corporation
Consumer Staples	2.4	Walgreens Boots Alliance, Inc.
Materials	2.0	Dow Inc.
Healthcare	1.7	Pfizer Inc.
Financials	1.5	Franklin Resources
Industrials	1.4	United Parcel Service, Inc.
Communication Services	1.0	Verizon Communications
Consumer Discretionary	0.7	Ford Motor Co.
Information Technology	0.7	Skywork Solutions, Inc.

As of 3/31/25. Data Source: Factset, 4/25.

There are many different ways to take advantage of dividends' benefits. Some funds are style pure and invest only in companies that have above-average yields and below-average valuations. These funds are more likely to have higher allocations in the higher-yielding sectors above. Other funds may combine dividend-paying companies with out-of-favor growth companies and cyclical companies in pursuit of both dividends and growth. These funds could have significant allocations to growth sectors such as technology that generally don't offer high yields but offer significant growth potential.

Dividend Payers Aren't Just for Retirees

When thinking about which investors dividend-paying stocks may be appropriate for, retirees and near retirees are likely the first group that comes to mind. These investors are typically seeking a reliable income stream that can help fund their retirement. While bonds also offer a reliable income stream and are usually less volatile than stocks, they typically have limited growth potential. Given that most people will spend 30 or more years in retirement, it's important to have some portion of a portfolio invested in equities that offer both growth and income.

But it would be a mistake to think that dividend-paying stocks are only for older investors. Over time, the compounding effect of dividends can result in significant capital appreciation. Going back to 1960, 85% of the cumulative total return of the S&P 500 Index can be attributed to reinvested dividends and the power of compounding (FIGURE 13). Younger investors can potentially grow their investments exponentially by investing in financially strong, dividend-paying companies and allowing them to compound over long periods of time.

FIGURE 13: Dividends Have Been a Major Factor in the S&P 500 Index's Growth

Growth of \$100,000 in the S&P 500 Index

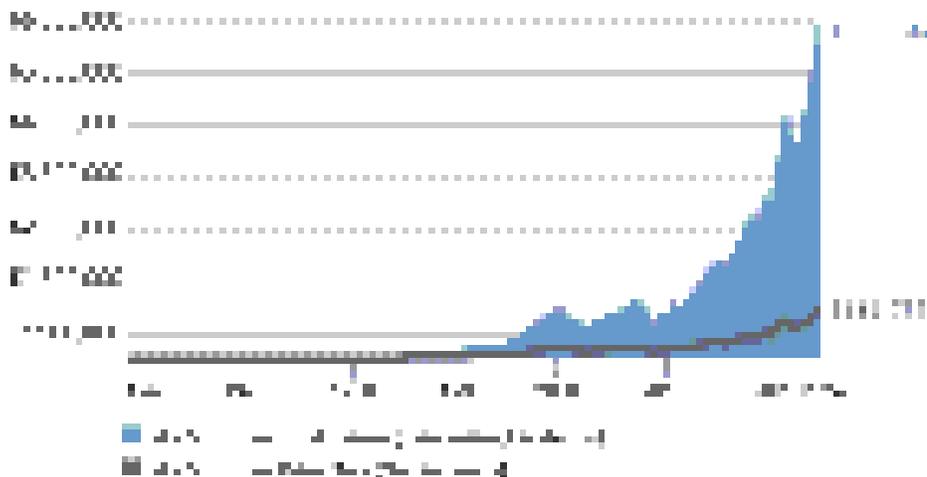


Chart Data: 1960-2024. **Past performance does not guarantee future results.** Indices are unmanaged and not available for direct investment. Dividend-paying stocks are not guaranteed to outperform non-dividend-paying stocks in a declining, flat, or rising market. For illustrative purposes only. Data Sources: Morningstar and Hartford Funds, 3/25.

Takeaways

Bonds look attractively valued compared to stocks based on their yield relative to stocks' earnings yield, and the average bond price is trading at a discount. Bond yields have historically been a good indicator of forward returns, and the current yield suggests potentially attractive returns going forward. Lower historical drawdowns for bonds relative to stocks highlight the important role fixed income can play in an investor's portfolio.

After years of underperforming domestic equities, international equities may finally be poised to outperform. The US makes up just 14% of the world's publicly traded companies, and most of the best-performing companies are outside the US. International equity benchmarks are less concentrated than the S&P 500 Index and offer higher allocations to cyclical sectors such as financials and industrials. If foreign investors choose to put their capital to work outside the US, the dollar could weaken, and international equities could benefit significantly.

Dividends are a sign of financial strength and have been a major contributor to the total return of the S&P 500 Index, especially when returns were in the single digits or lower. Companies that grew or initiated a dividend have provided higher returns with less volatility than companies with stable or no dividends. Older investors may benefit from the steady income stream provided by dividends, while younger investors may benefit from the power of compounding over decades.

While the specifics of what's rattling markets are likely to change day to day, it seems volatility is here to stay. Investors should consider examining their portfolios to see if they're truly diversified to help reduce concentration and volatility risk.

To learn more about strategies for volatile markets, please talk to your financial professional.

¹Data Sources: Morningstar and Hartford Funds, 4/25.

²Valuations as measured by P/E ratios. Data Source: Y charts

³Source: Bloomberg, "Great 'Bear Market in Diversification' Haunts Wall Street Pros," 4/25.

⁴Source: The Asahi Shimbun, "Japanese Firms Struggle to Find Areas to Mitigate Trump's Tariffs," 4/9/25.

⁵Source: Center for Economic Policy Research, "EU Supply Chain Tectonics," 4/3/25.

⁶Source: Invest India, "A Decade of Economic Transformation With 'Make in India,'" 9/30/24.

⁷Source: Peninsula Group Limited, "US Tariffs on Canada: Sourcing From Canadian Suppliers May Be the Answer," 3/6/25.

⁸Source: Wellington Management, "Could 'Liberation Day' Trigger a Shift in Capital Flows?," 4/25.

⁹Risk premium is the investment return an asset is expected to yield in excess of the risk-free rate of return.

¹⁰Source: Wellington Management, "What Do Tariffs Mean for Portfolios?," 4/25. Nanette Abuhoff Jacobson is a managing director and multi-asset strategist at Wellington Management and global investment strategist for Hartford Funds.

¹¹The Draghi Report, authored by former European Central Bank President Mario Draghi, outlines challenges faced by the European Union and provides recommendations to enhance economic growth and competitiveness.

Index Definitions:

Bloomberg US Aggregate Bond Index is composed of securities that cover the US investment-grade fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

MSCI EAFE Index is a free float-adjusted capitalization index that is designed to measure developed market equity performance, and excludes the US and Canada.

MSCI World ex USA Index is a free float-adjusted market capitalization index that captures large and mid cap representation across developed markets countries excluding the United States. MSCI performance is shown net of dividend withholding tax.

S&P 500 Index is a market capitalization-weighted price index composed of 500 widely held common stocks.

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