Is it too late to reduce risk in my portfolio?

November 2022

Is it too late to reduce risk in my portfolio? We've been asked this question quite a bit lately. As the market continues to test new lows in 2022, advisors and investors who have yet to allocate to low-correlating solutions wonder if they are too late to benefit from such an allocation. If you believe in the broad principles of diversification, then the answer should be clear.

It's never too late.

As the name implies, low-correlating investments offer diversification beyond traditional investments such as stocks and bonds—helping modern portfolios seek outperformance in both up and down markets. Additionally, low-correlating investments can be beneficial in targeting specific portfolio outcomes, such as volatility mitigation, income generation, or an inflation hedge—challenges investors will likely face for years to come. But to realize any of these potential benefits, investors need to forgo timing concerns, move off the sidelines, and invest.

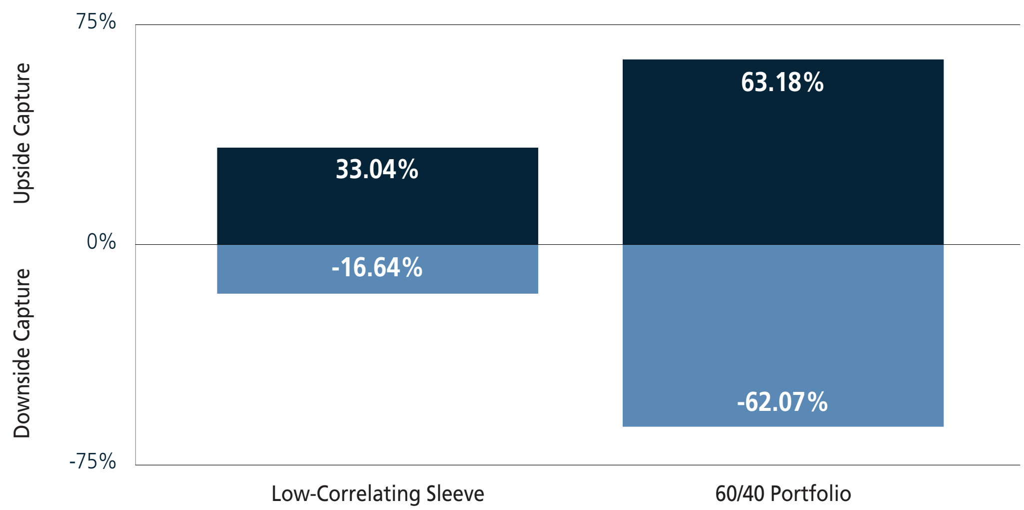
Key Takeaways

- Understanding a fund's correlation to other assets should be central to an investor's decision-making process.
- Low-correlating investments offer diversification beyond traditional investments, such as stocks and bonds—helping modern portfolios seek outperformance in both up and down markets.
- Having a permanent allocation to low-correlating strategies, just as you do to traditional asset classes, can help to avoid unforeseen market uncertainty.

Understanding a fund's correlation should be central to an investor's decision-making process. Correlations range on a scale from 1 (perfectly correlated) to -1 (perfectly *inversely* correlated). If your primary objective is diversification, an optimal correlation might range between -0.5 to 0.5. Anything below -0.5 has high inverse correlation, which could create a semi-constant drag on performance. On the other hand, for diversification purposes, anything above 0.5 could move too closely in tandem with equity markets.

Low-correlating strategies provide the opportunity to generate positive returns, while also reducing significant losses. As the chart below shows, a sleeve of low-correlating strategies can offer participation on the upside and risk mitigation on the downside when compared with a traditional 60/40 portfolio of stocks and bonds.

Upside/Downside Capture Ratio - June 1, 2013 - September 30, 2022

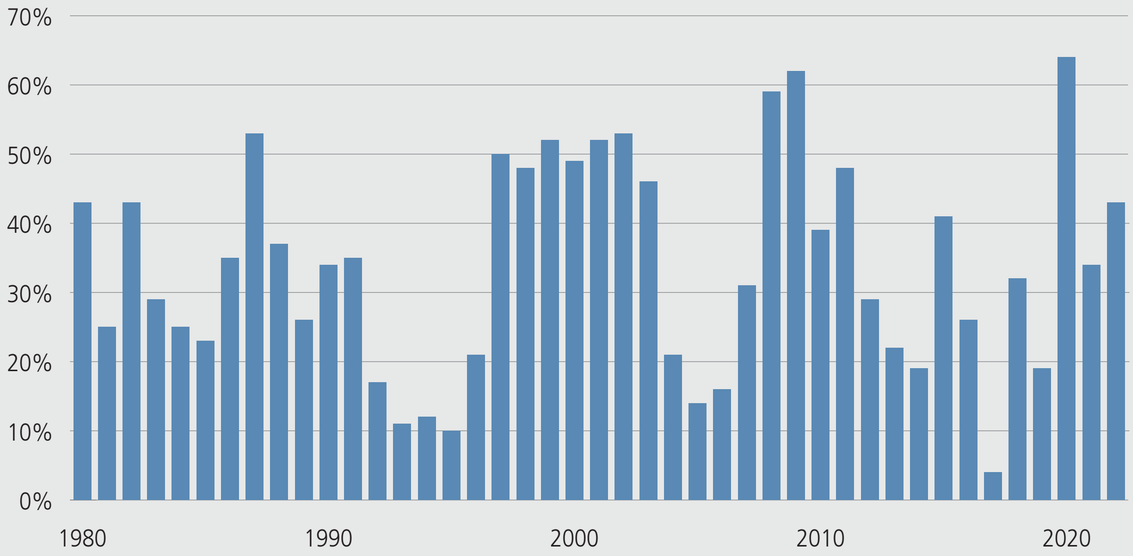


Source: Morningstar. Calculated using monthly data. The 60/40 Portfolio represents a 60% allocation to the S&P 500 Index and a 40% allocation to the Bloomberg U.S. Aggregate Bond Index, rebalanced monthly. The Low-Correlating Sleeve is equally weighted between LoCorr Macro Strategies Fund (LFMIX), LoCorr Long/Short Commodities Strategy Fund (LCSIX), and LoCorr Dynamic Equity Fund (LEQIX), rebalanced monthly. **Past performance is not a guarantee of future results.**

A Different Decade for Investors

The current market regime differs from anything we've seen in generations. The years following the Global Financial Crisis were a period characterized by low interest rates, low market volatility, and an upward trending market, but the markets have now entered unchartered waters. After an extended period of quantitative easing, the next decade is likely to look very different than the previous decade. The current market regime has higher interest rates, higher inflation, and higher volatility. The Federal Reserve has been transparent with its intention to raise interest rates until inflation stabilizes around 2%. However, the Fed is increasing interest rates at an alarmingly fast pace, causing frequent volatility in the markets with significant daily moves, as shown in the following chart.

Number of 1% Daily Moves by S&P 500 Index - January 1, 1980 - September 30, 2022



Source: Yahoo Finance. 2022 data through 9/30/2022.

Rather than trying to time the market, we believe low-correlating solutions deserve a permanent allocation in a portfolio.

This volatility continued in September, which was the worst month for equities and fixed income this year. The S&P 500 Index notched its worst month since March 2020. Bonds didn't fare much better, with the Bloomberg U.S. Aggregate Bond TR Index experiencing its second worst month since the Index was founded in 1980, leaving a hypothetical 60/40 portfolio down -20.06% year-to-date.*

With more interest rate hikes anticipated at both the November and December Fed meetings and into 2023, it leaves the possibility of continued market volatility or worse — driving the U.S. economy into a recession. Coupled with stocks and bonds both moving down in tandem this year and tightening credit conditions, investors need to ensure their portfolios have true diversifiers that may help smooth the ride. Having a permanent allocation to low-correlating strategies, just as you would to traditional asset classes, may help to avoid unforeseen market turbulence.

In this unprecedented time in the market, portfolios need a ballast that the traditional 60/40 can no longer provide. Low-correlating strategies may offer the diversification investors are seeking for today's market landscape and beyond.

Time to invest.

*As of 9/30/2022 using SPY and AGG ETFs.

To learn more about how LoCorr can help you reach your investment goals, contact us at **888-628-2887** or visit us at **www.LoCorrFunds.com**.

LoCorr Funds is a leading provider of low-correlating investment strategies founded on the belief that non-traditional investment strategies with low correlation to stocks and bonds can reduce risk and help increase portfolio returns. LoCorr offers investment solutions that provide the potential for positive returns in rising or falling markets and help to achieve diversification in investment portfolios.

Diversification does not assure a profit or protect against loss in a declining market. Correlation measures how much the returns of two investments move together over time. Up Capture compares an investment's performance against its benchmark during periods when the benchmark's performance is positive, while Down Capture compares the investment's performance against the benchmark during periods when the benchmark's performance is negative. A value of greater than 100% indicates that the investment captured more return than the benchmark (this is a positive for Up Capture, however, a negative for Down Capture). Conversely, a value less than 100% means the investment captured less return than its benchmark (a positive for Down Capture, but a negative for Up Capture). Quantitative easing refers to the Federal Reserve's purchases of large quantities of Treasury securities and mortgage-backed securities issued by government-sponsored enterprises and federal agencies to achieve its monetary policy objectives.

The Fund's investment objectives, risks, charges, and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and it may be obtained by calling 1.855.LCFUNDS, or visiting www.LoCorrFunds.com. Read it carefully before investing.

Mutual fund investing involves risk. Principal loss is possible. The Funds are non-diversified, meaning it may concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the Funds are more exposed to individual stock volatility than a diversified fund. The Funds invest in foreign investments and foreign currencies which involve greater volatility and political, economic and currency risks and differences in accounting methods. These risks are greater for emerging markets. The Funds may make short sales of securities, which involves the risk that losses may exceed the original amount invested. Investing in commodities may subject the Funds to greater risks and volatility as commodity prices may be influenced by a variety of factors including unfavorable weather, environmental factors, and changes in government regulations. Investing in derivative securities derive their performance from the performance of an underlying asset, index, interest rate or currency exchange rate. Derivatives can be volatile and involve various types and degrees of risks, and, depending upon the characteristics of a particular derivative, suddenly can become illiquid. Derivative contracts ordinarily have leverage inherent in their terms which can magnify the Fund's potential for gains or losses through increased long and short position exposure. The Fund may access derivatives via a swap agreement. A risk of a swap agreement is the risk that the counterparty to the agreement will default on its obligation to pay the Fund. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investments in Asset Backed, Mortgage Backed, and Collateralized Mortgage-Backed Securities include additional risks that investors should be aware of such as credit risk, prepayment risk, possible illiquidity and default, as well as increased susceptibility to adverse economic developments. The LoCorr Long/Short Equity Fund may invest in small- and medium-capitalization companies which involve additional risks such as limited liquidity and greater volatility. The Fund may also invest in lower-rated and non-rated securities which present a greater risk of loss to principal and interest than higher-rated securities. ETF investments are subject to investment advisory and other expenses, which will be indirectly paid by the Fund. As a result, the cost of investing in the Fund will be higher than the cost of investing directly in ETFs and may be higher than other mutual funds that invest directly in stocks and bonds. ETFs are subject to specific risks, depending on the nature of the ETF. The Spectrum Income Fund's portfolio will be significantly impacted by the performance of the real estate market generally, and the Fund may be exposed to greater risk and experience higher volatility than would a more economically diversified portfolio. Property values may fall due to increasing vacancies or declining rents resulting from economic, legal, cultural, or technological developments. Investments in Limited Partnerships (including master limited partnerships) involve risks different from those of investing in common stock including risks related to limited control and limited rights to vote on matters affecting the Limited Partnership, risks related to potential conflicts of interest between the Limited Partnership and the Limited Partnership's general partner, cash flow risks, dilution risks and risks related to the general partner's limited call right. Underlying Funds are subject to management and other expenses, which will be indirectly paid by the Fund.

Bloomberg U.S. Aggregate Bond Index is a broad-based bond index comprised of government, corporate, mortgage and asset-back issues rated investment grade or higher. **S&P 500 Index** is a capitalization weighted unmanaged benchmark index that includes the stocks of 500 large capitalization companies in major industries. This index includes net dividends and is calculated by adding an indexed dividend return to the index price change for a given period.

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