Winter 2021

360 Insights

Our Bond with Bonds
(Even in a Low-Interest-Rate World)

By Jonathan Scheid, CFA, AIF®

Investing is a series of trade-offs. Every one of us has a finite amount of money, and we must determine how much we want to put where. Placing a large portion of our money in stocks means we might have tremendous upside potential, but it also means we won't be able to put a lot of money in the cash and bonds that help stabilize some of the ups and downs of stocks. Placing all our money in cash and bonds might not get us the growth we need to meet our financial life goals.

Determining how much to put in stocks versus bonds is a vital decision, one that your financial advisor can help you make with confidence. And the trade-offs don't stop there. There's a multitude of asset classes underlying the broad categories of stocks and bonds, and the decisions that we make in selecting each of those asset classes could be the difference between achieving our goals or falling short. Fortunately, there is a sizable body of industry and academic evidence that we can rely on to make informed decisions about these trades-offs.

The bonds we want (and don't want) in our portfolios

Our review of the evidence points us to using stocks for growth and bonds for preservation and volatility management. Stocks historically have posted significantly higher growth rates than bonds, so holding stocks for growth makes sense. Bonds historically have grown as well, just not as fast as stocks. Also, different types of bonds behave differently, as some bonds historically have moved in the same general direction as stocks, and some historically have moved in the opposite direction. Evaluating the trade-offs between the type of bonds we use in our portfolios is key.

Because we want the bonds in our portfolios to hold their value, or even go up in value when stocks fall, we need bonds that tend to move in the opposite direction of stocks. The type of bonds that meet this criterion are high-quality bonds and/or short- to intermediate-term bonds. High-quality bonds typically are issued by governments that have the ability to create money to repay them or by well-established companies that generate sufficient revenue and profits to service the debt. We tend to like short- to intermediate-term bonds because you get your money back sooner, allowing you to reinvest in better rates if they are available.

In the first quarter of 2020, when the global stock markets were falling on news of the COVID-19 pandemic, high-quality, short- to intermediate-term bonds did what we wanted them to do. They generally held their value and, in most cases, went up in value. This was a picture-perfect example of why we use these types of bonds. In fact, having money in assets that go up when stocks go down gives us the ability to rebalance, where we could potentially sell appreciated bonds and buy depreciated stocks. It also helps us avoid selling stocks at depressed prices to fund our lifestyle expenses.

As expected, not all bonds rose in value during the COVID-19 market decline of 2020. Investments like high-yield bonds, bank loans (also known as floating-rate notes), and lower-rated investment-grade bonds fell in value alongside stock prices. These types of investments became more popular with investors over the past decade as they sought higher interest rates from their bonds (which they had to take a lot more risk to get). Investors who pursued these bonds saw everything in their portfolio decline at the same time, likely quite a disappointing experience. (continued on page 2)

Build on Your Momentum in the New Year

Ready to leave 2020 behind and move on? Sure, turning the calendar into 2021 could feel like a somewhat arbitrary milepost on the arc of our now almost year-long global health crisis and its resulting social and economic realities. But the event can of course still serve as a handy catalyst. What thing that didn't get done last year irritates you the most? Or to flip that question around, what's most important to you today, this month, and beyond? Capture any momentum from ushering in a new year to take some small steps in those or other big areas. So, how will you advance your financial life plan and overall wellbeing in 2021? Consider these ideas, and then ask yourself, "What else?"

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The role of bonds in a low-interest-rate world

As we enter 2021, the interest we earn from our bonds is still very low. While this might tempt some investors to explore taking more risk with their bonds, we would urge you to recall that we use bonds to protect your financial life plan and to offset the ups and downs of stocks. Even with low interest rates, those benefits still exist.

We remain proponents of having evidence to support each investment trade-off that we make in our portfolios. In the case of bonds, we feel the evidence still strongly supports the use of high-quality, short- to intermediate-term bonds. In a total portfolio, these types of bonds play a crucial role.

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Family & Relationships

- Do you Zoom? Build on holiday impetus to set up a regular conversation with friends and family
- Help prepare the next generation for their financial futures by setting that next family meeting
- See more and do more by adopting an abundance mindset with your loved ones

Work & Career

- Working from home? It's certainly no vacation, but that doesn't mean you can't take one
- Get right with your 401(k), perhaps by "banking" that raise in your contributions
- Go back to thinking bigger – past the pandemic – about your career path

Health & Wellness

- Set up a financial self-care routine and record it in a planner (bonus: it helps beat stress)
- Embrace incrementalism as you work a plan that value-maximizes money decisions
- Choose to practice mindfulness, from meditation to gratitude lists

Interests & Causes

- Because giving back can make you happier, look for virtual volunteer opportunities in your community
- If circumstances around COVID-19 have led to choice conflict, refocus your charitable intentions on what's most important to you
- Revisit how your giving strategy (and estate plan) fit into the larger legacy you want to leave

Market Trends Affecting Your Portfolio

By Daniel Campbell, CFA

If I told you that we'd have a partial breakup of the European Union, a contested U.S. election, an economic contraction, and a global pandemic over the course of a year, would you expect the stock market to be up or down? Most of us might guess that the markets would be down (probably significantly). Few may have predicted that the markets would continue to set record highs. But that was 2020: a year of the unprecedented. Britain left the European Union, the first country ever to do so. The U.S. election was hotly contested, bringing out a record number of voters. And the defining event of 2020 – a global pandemic – upended normal life. Best-case scenario, it only changed the way we work, travel and connect with family and friends.

While we may have cheered the end of 2020, the occasion also offers an opportunity to reconcile the many and perhaps disparate events of last year. For instance, despite that economists widely expect the economy to have shrunk in 2020,[1] the U.S. stock market posted strong positive performance for the year. Large growth companies, like Microsoft, Apple and Amazon, did exceptionally well as the pandemic created more demand for their services. Value stocks, which are companies with a low stock price relative to their earnings or accounting book value, performed sluggishly as investors tried to process how retail, food services and entertainment will look on the other side of the pandemic.

Uncertainty around the pandemic also scared many investors into selling equities and buying U.S. Treasury bonds. The Federal Reserve committed to keep the overnight lending rate low until we see average inflation closer to 2%, and as a result, yields for high-quality Treasury bonds have stayed near record lows. This was a big tailwind for fixed income returns this year, but it also means we need to be ready to accept lower fixed income returns going forward. Meanwhile, stock performance outside the U.S. was basically flat, and to the surprise of many, emerging market stocks turned in positive performance for the year.

All of this will be reflected in your portfolio's performance. Every stock fund you own has purchased shares in hundreds, if not thousands, of companies, and they are set to benefit or be impaired by these global trends. For example, funds owning more large technology stocks could be some of your best performing investments and funds owning value stocks could be some of your worst performing investments. 2020 reminded us that it is not only impossible to predict what's going to happen next, but also extremely difficult to know how those events will affect the stock market. That's why we've built you a portfolio to meet your specific, long-term financial life goals, and also why that portfolio owns thousands of stocks across dozens of countries. Going into 2021, stock prices now reflect the market's expectations for how companies will continue to weather COVID-19 and the changing business landscape.

Whatever happens in 2021, know that we have designed your portfolio to benefit in some amount from every trend, so you can focus on what matters most to you instead of worrying about which stocks are benefiting most from the market's latest reflex.

[1] Federal Reserve Bank of Philadelphia, Fourth Quarter 2020 Survey of Professional Forecasters

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