ADVISOR PERSPECTIVES

The "Other" Problem for Bond Investors

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For a while now, my firm and I have been devout in alerting our clients and blog subscribers to the issues that will confront them as investors if/when the more than three decades of generally falling U.S. interest rates reverses itself. But what if they don't rise much for a while, and instead stay around where they are? Is that a victory for bond bulls and does it make those warning about an eventual bond bear market a bunch of Chicken Littles? Hardly. Because regardless of where rates go on high-quality bonds, the math of bonds works against investors who are in or nearing retirement.

Now, "interest rates" can be anything from money market funds and CDs, to muni and corporate bonds, to mortgages and business loans and more. So, we often attempt to simplify the discussion by focusing on potential movements in the price and yield of the 10-year U.S. Treasury Bond. From what we have observed, this is the most commonly-referenced benchmark for the general direction of bond prices and interest rates.

Sungarden Investment Research 2014

The table above is one we used in our popular January, 2014 research paper, "The Sungarden Study" (which you can access at www.hedgedinvesting.com). It shows what is projected to happen if the 10-year bond moved to various price/interest rate levels of the next five years. We have updated this from January to earlier this week. What it shows us is that high-quality bonds such as Treasuries are most likely to produce returns in the 2% range or worse over the next five years. If your money is managed by someone buying bonds, perhaps half of that return goes to fees. If you are a taxable investor, that also reduces your return. You may even end up with all of your returns going to taxes and fees. This is conjecture right now, but the math shown in this table is real. Treasuries cannot magically make 10% a year over the next five years. Its mathematically impossible for them to reach anywhere near that. And the possibility of negative returns (after and even before taxes and advisory costs) is very real.

It is beyond our comprehension how so much retiree money is invested in what seems to be near-certain destruction of wealth. That is why for years we have not owned high-quality bonds, and created our own approach to the pursuit of income, preservation and growth for our clients. Bond buyer....beware.