As Bonds Rapidly Decline, Where's the Safe Income?

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In turbulent economic times, investors rely on safe harbor investments to weather the storm. Many investors need and desire investments that generate income, especially in the near term to mid-term, which will not risk substantial risk of loss of principle. Year to date (2/3/2022) bonds (represented by AGG) have lost approximately 1.84% of value with an income yield of less than 2%. Yes, that means that in the first month of the year you have already lost most of the year's income. In 2021, Aggregate bonds (AGG) lost 1.67%, including the income. Bonds have averaged a total return for the last decade of just 2.93%. That is a before-tax return of 29.3% for the decade. Over 50% of that return came in 2019 and 2020 when interest rates plummeted to zero and beyond globally.

AGG			
Last 10 yrs. 2012-2021			
Total Return			
2012		4.22%	
2013		-2.02%	
2014		5.97%	
2015		0.55%	
2016		2.65%	
2017		3.54%	
2018		-0.05%	
2019		8.68%	
2020		7.42%	
2021		-1.67%	
Average Total Return		**2.93%**	

Source: www.thebalance.com

The Fed and other world banking authorities have signaled the need to aggressively increase interest rates along with tightening monetary policy.

WHEN INTEREST RATES INCREASE, BOND INVESTORS LOSE PRINCIPLE,

IF THAT DOES NOT SOUND VERY SAFE, IT IS ONLY BECAUSE IT IS NOT!

On January 27th, 2022, the average US interest rates were a meager 1.37%. The year 2001, was the last year with average interest rates this low. In 2001, the tech-heavy NASDAQ lost 32.65% after losing. 36.84% in 2000. The following year 2002, the NASDAQ almost lost 37.58%, which is why interest rates were so low in 2001.

WHEN INTEREST RATES RISE AND RISK ASSETS DECLINE, IT CAUSES SIGNIFICANT PORTFOLIO STRESS!

Source: *Multiple*

Jan 27th	2022		1.37%	
Dec	2021		1.29%	
	2020		1.58%	
	2019		1.83%	
	2018		2.09%	
	2017		1.84%	
	2016		2.03%	
	2015		2.11%	
	2014		1.92%	
	2013		1.94%	
	2012		2.20%	
	2011		2.13%	
	2010		1.83%	
	2009		2.02%	
	2008		3.23%	
	2007		1.87%	
	2006		1.76%	
	2005		1.76%	
	2004		1.62%	
	2003		1.61%	
	2002		1.79%	
	2001		1.37%	

Source *: https://advisor.visualcapitalist.com/us-interest-rates/*

How Long Will this Loss in Bonds Last?

Dorothy Neufeld in her article dated October 1st, 2020, titled “Visualizing 200 Year History of U.S. Interest Rates” from visualcapitalist.com states the following:

1. “Interest rates usually have cycles that last between 22 to 27 years.”

2. “When falling rates switched to rising trends these reversals typically average 2 to 14 years.”

That is strong evidence that the pain of loss in the bond market is likely to persist for an annoying length of time. Average interest rates in the 1970s were between 6 and 11% and generally rose. In the 1980s interest rates averaged between 8 to 14% and we're declining by the end of the decade. Interest rates continued trending lower in the 1990s and yet still ranged from 5 to 8%. For over 30 years interest rates remained no lower than 5% and provided a consistent level of income.

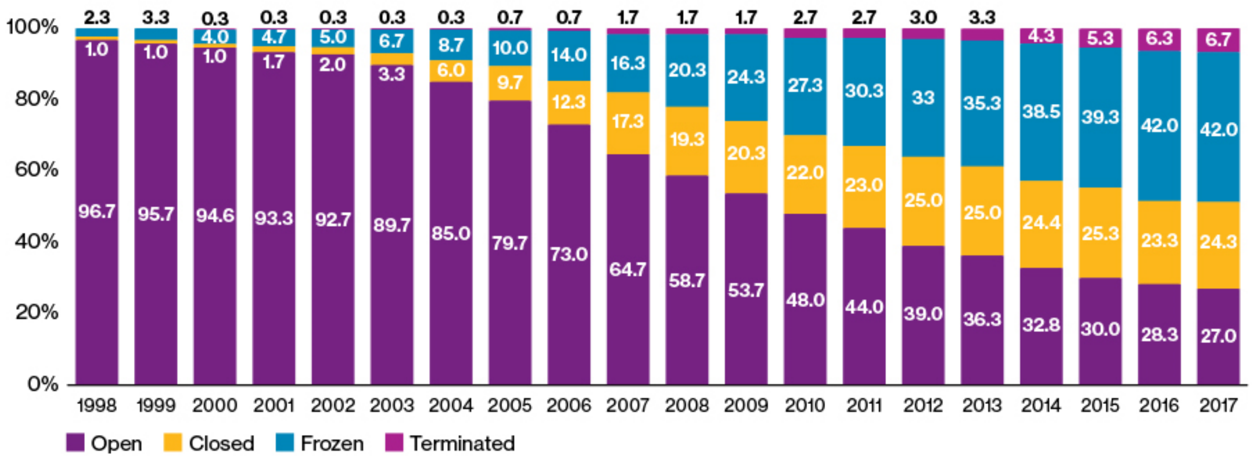
Since 2001, interest rates have declined steadily down to zero.

Dorothy's conclusion, based on these trends, was “Investors may want to rethink traditional assets allocations between fixed income, equities and alternatives.”

Since that article was written, interest rates have accelerated, and stocks have declined significantly.

***Source**: http://advisor.visualcapitalist.com/us-interest-rates/*

The need for income today has grown because of both the number of baby boomers who are approaching or are at retirement age and because fewer companies than ever offer income from pensions.



Source:https://www.wtwco.com/en-US/Insights/2018/02/evolution-of-retirement-plans-in-fortune-500-companies

In 2021 wages rose 4.7% while consumer prices rose 6.8%. In 1998, 58% of Fortune 500 companies offered a pension or hybrid retirement plan to their employees versus in 2019 whereas only 14% of them did. More of the responsibility to provide income has shifted to the individual at a time when interest rates are declining, and market volatility has skyrocketed. When you add the significant risk of inflation to this mix it only increases portfolio stress.

***Source:** Jeffrey Bartash-Market Watch, 1/7/2022*

HOW CAN I ADDRESS RISK OF LOSS IN BOTH MY BOND PORTFOLIO AND STOCK PORTFOLIO?

Be Tactical:

This means responding with action to reduce portfolio risk and taking corrective measures that reflect 2 things.

A. Your specific income and growth needs.
B. The current economic environment.

Remembering that money has no memory can be helpful in this tactical process.

1. Consider capturing gains from assets that have outsized gains in recent years. Of course, talk to your Tax Accountant and Financial Advisor to fully understand the consequences of your transactions.
2. Consider exiting fixed income investments that will likely continue to lose money.
3. Create a plan to re-enter volatile equities market systematically based on sound economic metrics.
4. Consider adding alternative income products and private pension plans.
5. Use alternative asset classes for instance, precious and non-precious metals, as well as broader-based commodities and other inflation-sensitive asset classes.

A plan that is dynamic and tactical will allow you to effectively manage risk assets and reduce portfolio stress while providing the necessary income.

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Robert joined Carlson Financial Services, LLC in March 2016 to serve clients financially and provide sound, independent advice that allows each client to align their faith and values with their finances. With this holistic approach, Rob integrates the 6 Key Areas of Planning into a comprehensive financial plan tailored for each individual's specific needs, goals, and desires. Rob is a Raleigh native, is married, and serves as a Deacon at his local church. Outside of the office, he is usually bass fishing or enjoying the North Carolina mountains.

As an Investment Advisor Representative, he currently holds a Series 65 Securities License, along with his Bachelor of Science degree in Accounting from North Carolina State University.