Breaking down common objections to fixed-income investments

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With higher interest rates in recent years, fixed-income investments can provide more benefits.

We believe now is a good time to consider adding fixed income to your portfolio:

1. Interest rates have risen from historical lows, which means bond investments can provide more income.
2. We expect the increased market volatility to continue because of the possibility of an economic recession and political tensions worldwide.

While more stock market volatility can be uncomfortable, it doesn't necessarily mean the bull market is over. Even though we don't expect stock returns to be as high as in the past few years, our outlook for stocks is still positive based on our economic and earnings growth outlook.

What does this mean for your portfolio?

- Make sure you've worked with your financial advisor to complete the critical first step of portfolio construction: having the proper mix of equity (stocks) and fixed income (bonds). That mix should be based on your goals and comfort level with risk.
- You may need to add fixed income to help reduce your portfolio sensitivity to market fluctuations. Because stocks and bonds typically move in opposite directions, bonds can help steady portfolios when stock markets fluctuate.

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Making the case for fixed income

Bonds can offer attractive diversification benefits today. So why do some investors avoid fixed income?

Some common objections are:

1. Stock returns are typically higher than bond returns.
2. Current bond rates are too low.
3. Stocks with high dividend yields are a more attractive substitute for bonds.

Objection 1: Stock returns are typically higher than bond returns.

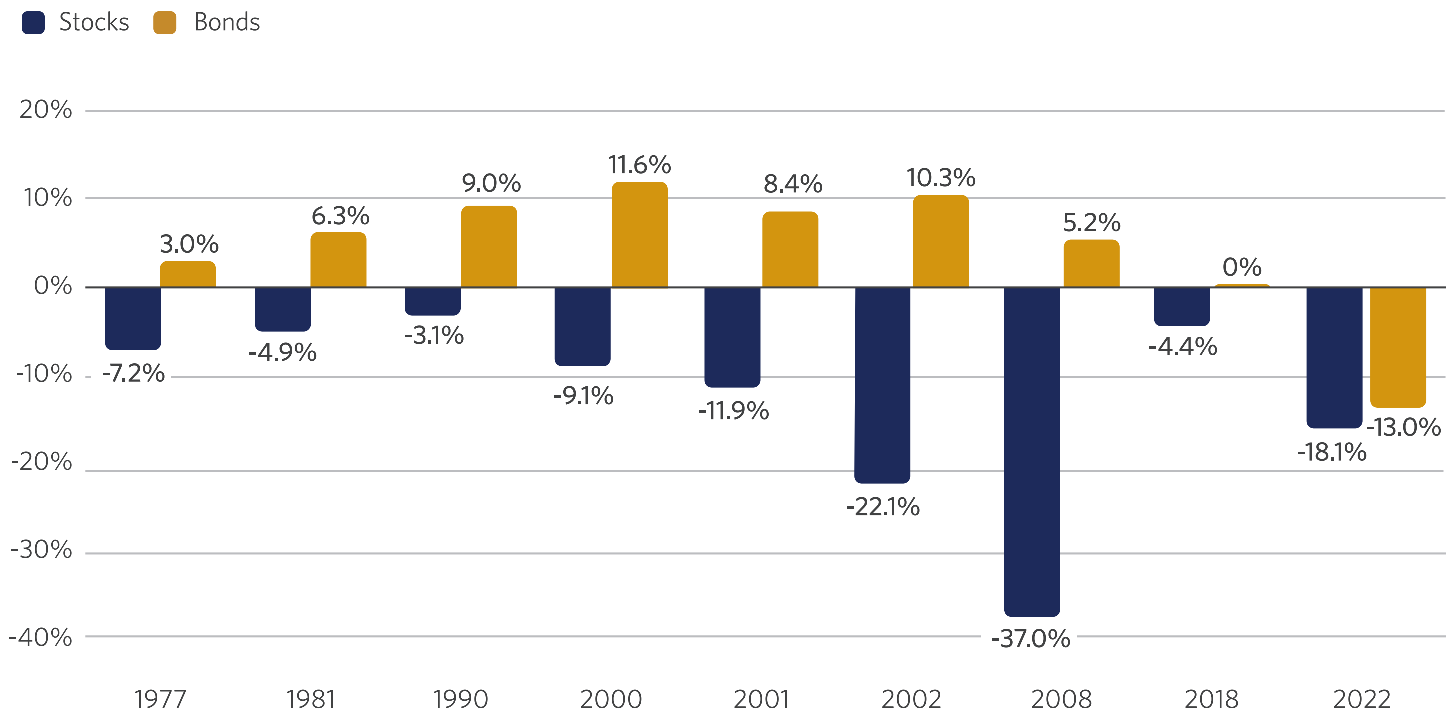
While stocks have delivered strong returns over time, they do experience declines. It's during these downturns that bonds tend to perform well.

As the chart below shows, in each of the past nine years when stock markets dropped, bonds had positive returns, with one exception. That inverse relationship typically helps a portfolio of stocks and bonds experience less volatility than one more heavily invested in stocks.

Remember, your portfolio's mix of stocks and bonds should be based on your goals and comfort with risk. Generally speaking, the more stock investments you own, the more risk you're taking — but you'll also have the potential for higher long-term returns.

Bonds help cushion stock market declines

Years of declining stock prices



Source: Morningstar, total return. Stocks represented by the S&P 500 Index. Bonds represented by the Bloomberg Barclays U.S. Aggregate Bond Index. Investment indexes are unmanaged and are not available for direct investment. The market's past performance is not a guarantee of how it will perform in the future.

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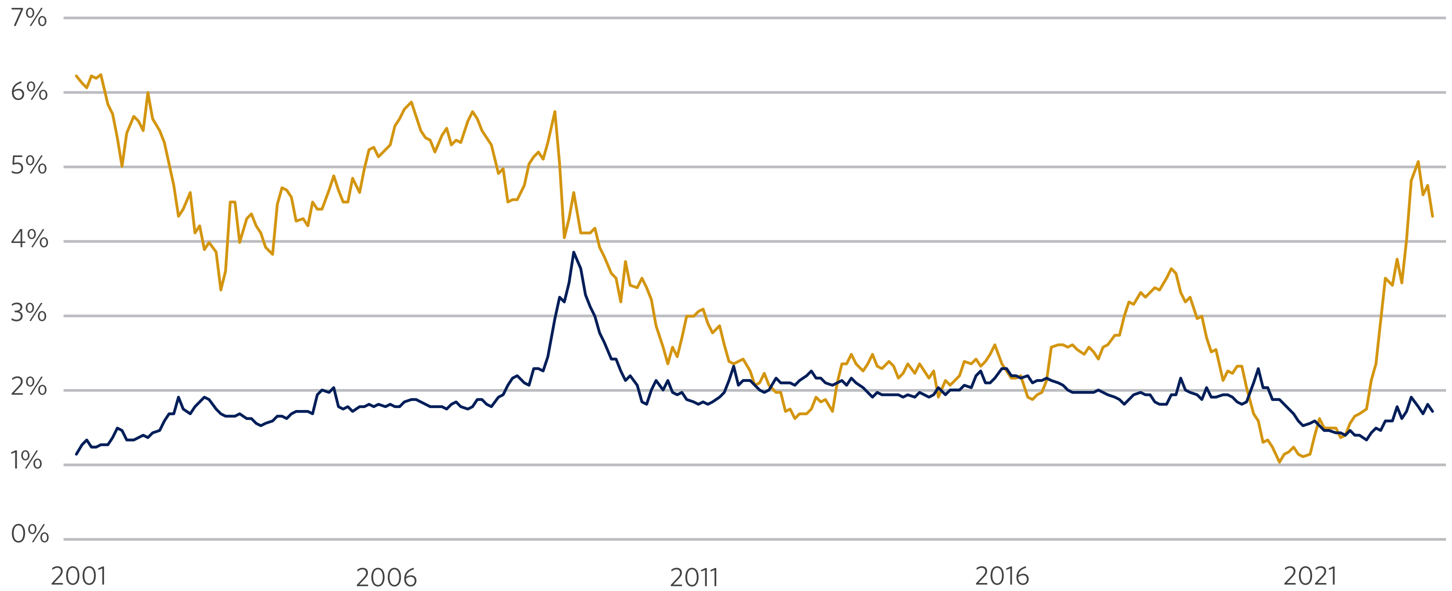
Objection 2: Current bond rates are too low.

Bonds typically provide more income than most stocks. As the chart below shows, with higher interest rates in recent years, this is true again today.

Bond rates vs. dividend yields



Source: Morningstar Direct, Bloomberg Barclays Indices; bond rates represented by Bloomberg Barclays U.S. Aggregate Index Yield-to-worst. Dividend yield on stocks represented by average dividend yield for S&P 500 Index.

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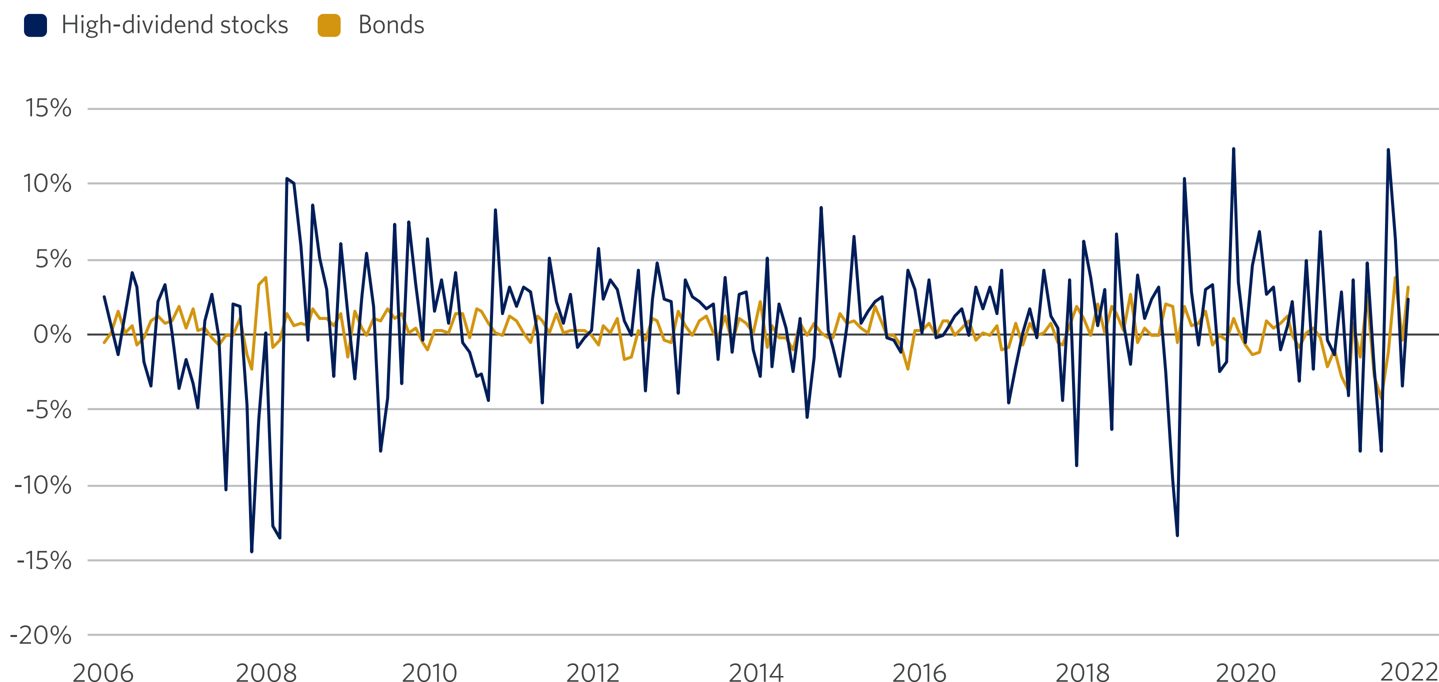
Objection 3: Stocks with higher dividend yields are a more attractive substitute for bonds.

Simply put, high-dividend stocks are not bonds. We think dividend-paying stocks — particularly dividend-growing stocks — should be a core component of your diversified portfolio. However, remember that they belong in the equity (or stock) portion of your portfolio — not as a replacement for bonds in your fixed-income portion. Historically, bonds have been less risky than stocks, including those that pay high dividends. The following chart shows how fluctuations in high-dividend stock returns have been larger than those of bond returns.

Additionally, focusing too much on high-dividend stocks can result in outsized allocations to a few sectors that tend to pay higher dividends. These sectors tend to provide less potential for earnings growth. Again, this doesn't mean you should avoid dividend-paying stocks. It's substituting high-dividend stocks for fixed income that can add more risk to your portfolio than originally intended.

High-dividend stock and bond monthly returns



Source: Morningstar Direct, Bloomberg Barclays Indices. High-dividend stocks represented by the FTSE High Dividend Yield Index. Bonds represented by the Bloomberg Barclays U.S. Aggregate Bond Index. Investment indices are unmanaged and cannot be invested in directly.

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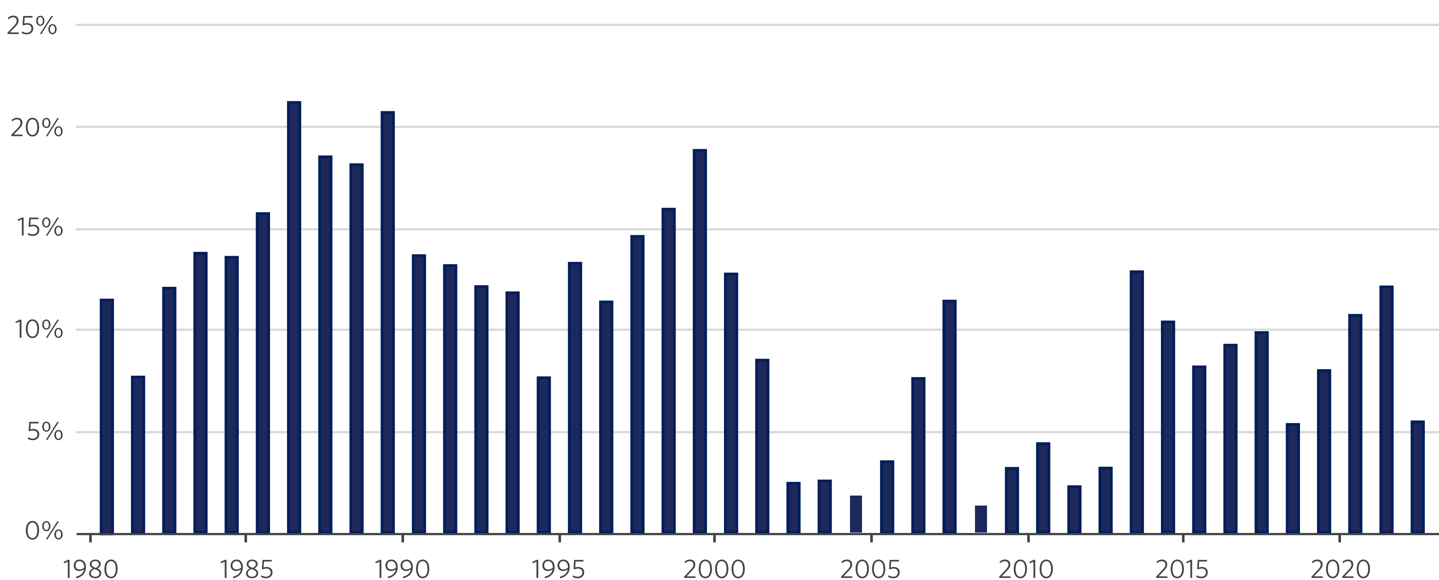
Balanced and diversified portfolios perform well

Identifying and maintaining the right mix of stocks and bonds is one of the most important investment decisions you can make. That means you should review your portfolio regularly with your financial advisor.

Diversification alone cannot guarantee success, but with an appropriate longer-term perspective, the proper mix of stocks and bonds can help keep your investments working toward your financial goals — particularly in challenging or volatile markets. The chart below represents the rolling five-year annualized returns of a hypothetical portfolio, rebalanced annually, with 65% in stocks and 35% in fixed income.

The value of diversification

Portfolio of 65% U.S. & international stocks, 35% bonds (5-year annualized return)



Source: Morningstar Direct; Bloomberg Barclays Indices. U.S. stocks (48.75% of portfolio) represented by the S&P 500 Index; international stocks (16.25% of portfolio) represented by the MSCI EAFE NR Index; bonds represented by the Bloomberg Barclays U.S. Aggregate Bond Index. Indexes are unmanaged and are not available for direct investment. Portfolio rebalanced annually. Past performance is not a guarantee of future results.

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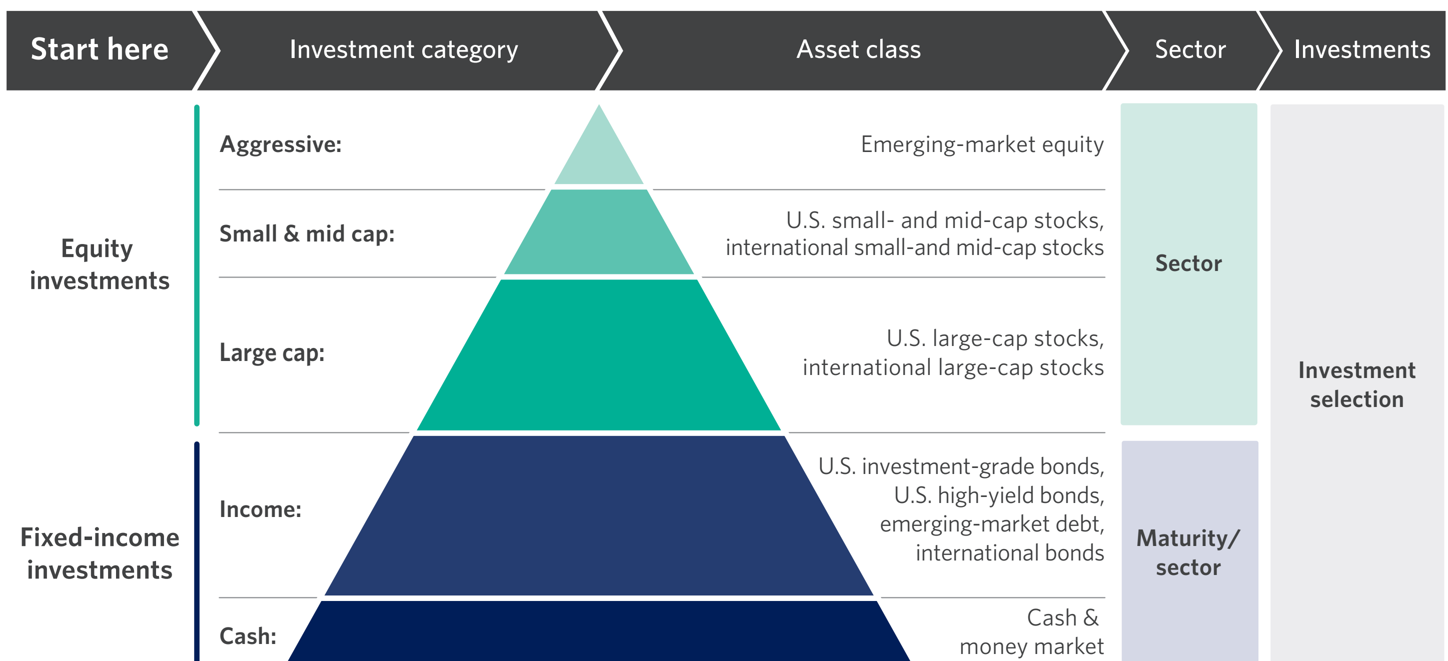
Three actions to take today

1. **Check your mix of stocks and bonds.**
   Talk with your financial advisor about your long-term financial goals and how much risk you're comfortable taking to help achieve them. Has anything changed in your life that might affect this discussion?

2. **Diversify your portfolio across asset classes.**
   After you've determined the right mix of stocks and bonds for your portfolio, take it a step further. Whether it's through bond funds, ETFs, UITs or individual bonds and CDs, consider diversifying among five different asset classes: U.S. investment-grade bonds, international bonds, U.S. high-yield bonds, emerging-market debt and cash. Your financial advisor can partner with you to determine the right mix for you.

3. **Own bonds of varying maturities.**
   Keep in mind, bond prices typically decline in a rising interest rate environment. But long-term bond prices generally fall more than short-term bond prices. That's why we recommend owning a bond portfolio of varying maturities, with up to 85% in short- and intermediate-term bonds. Then, as shorter-term bonds mature, you'll be better positioned to invest in new bonds at potentially higher rates.



Commodities, alternative investments, stocks trading less than $4 and international high-yield bonds, which align with aggressive investment categories, are not displayed because they are not recommended.

Keep in mind, you control the mix of stocks and bonds you own, but you don't control the markets. Work with your financial advisor to make sure your portfolio's investment mix is aligned with your financial goals.

Before investing in bonds, you should understand the risks involved, including credit risk and market risk. Bond investments are also subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease, and the investor can lose principal value if the investment is sold prior to maturity.

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