5 Critical Mistakes to Avoid as a Bond Investor in 2018

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Series I of II

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Interest Rates are Rising

Is the volatility in bond yields keeping you up at night? Concerned about further interest rate hikes? Is your broker telling you not to worry about the losses in your bond portfolio because you may "recoup" lost principal at maturity? Don't be passive in this environment; in the first of a two-part series, we will introduce active strategies that may be more effective. First, let's dive into five critical mistakes to avoid when investing in today's market.

5 Critical Mistakes to Avoid for Yield-Seeking Individuals

1. **Continuing to invest in bonds the same way:**
   The 36-year Bull Bond Market is over[1]. Since early 1990, the 10-Year US Treasury Yield Curve has transitioned from around 9% to a record low of 1.375% on July 5, 2016, offering investors the opportunity to actively trade *down* the yield curve over a long period of time. Where will rates go over the next five years? The Fed continues to indicate a rising interest rate environment, so it is important to be willing to adjust your investment approach accordingly. How are you planning to transition your strategy given this new environment? Do you plan to maintain status quo? Buy, ladder and hold to maturity? Extend duration or credit risk to pick up yield? If this is your plan, are you comfortable with a potential loss in the fixed income allocation of your portfolio? Or should you consider a different, possibly more active strategy?
2. **Shifting to a cash allocation:**
   More often than not, making the shift to a significant cash allocation will not be of benefit to investors. Making a significant allocation change from fixed income to cash will most likely cause the investor to underperform the market as well as lag inflation
3. **Expecting to properly time the Fed's interest rate cycle:**
   Expecting to properly time and predict the Fed's interest rate cycle is unrealistic. Market and Fed timing is extremely difficult to predict to exactness. You may get lucky once, but do not mistake this luck for knowledge or else you may end up severely underperforming the broader market.
4. **Using structured note products:**
   Brokers may actively solicit individuals with a double digit "teaser-rate" that may be good for only the first year or a limited term. Unfortunately, that teaser-rate may quickly evaporate in the following period as the structured note resets based on the underlying investment. This can mean that the investor is stuck with an illiquid asset with little income over an extended period.
5. **Engaging in floating rate bank loans[2]:**
   Intermediate and long-term floating rate bank loans can make for great marketing in a rising rate environment. These loans typically reprice based on LIBOR changes; however, the loans may be callable and they have been called at record percentages. 60% of bank loans were called in the first three quarters of 2017, with more likely to occur. This results in lower than average coupons during a period where the Fed will continue raising interest rates.

What's Next?

We believe that investors can benefit from rising interest rates over a full market cycle *if* they make proper decisions today. If you are concerned with your fixed income portfolio in a rising rate environment, contact Constantine Hatzivassiliou today for a free review of your portfolio. Mr. Hatzivassiliou will work with you to craft a plan that addresses your concerns.

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[1] Source: https://www.forbes.com/sites/investor/2018/02/11/the-end-of-the-36-year-bond-bull-market/2/#29aa65ac331e

[2] Source: https://www.alliancebernstein.com/library/is-the-bank-loan-market-showing-cracks