ADVISOR INVESTING | THE BIG Q

Bonds 'Stink.' Do They Still Have a Place in Client Portfolios?

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By Andrew Welsch and Ross Snel
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Bonds just aren't what they used to be.

Advisors are increasingly exploring alternatives to what was long a mainstay of client portfolios due to yields being near all-time lows as well as the risk of rising interest rates. For advisors and investors alike, it's a tough problem to solve.

"Bonds stink right now," *Barron's* Jack Hough said on a recent Streetwise podcast. "But you still need them."

With that in mind, Barron's Advisor checked in with several wealth managers to see how they're tackling this conundrum. It's part of the Big Q, our regular feature where we ask advisors and wealth management executives for their best answers to challenging questions. This week's query: **What place, if any, do bonds still have in client portfolios?**

Stephanie Lang
Courtesy of Homrich Berg

Stephanie Lang, chief investment officer at Homrich Berg: Relative to our peers that might have a 60/40 portfolio, our allocations to bonds are much smaller. We've gone into other areas, like alternative investments [and hedge funds], to serve the role of bonds. The hedge funds we use are lower volatility, with mid-single digit returns, and are closer to bonds. We think that given where bond yields are, which is close to all-time lows, you can easily outperform bonds. Another part of the allocation of bonds is going to private alternatives. For clients willing to lock up their money, we would encourage them to look at areas like private debt, where you can get much higher yields than in the public markets.

We still use bonds, we've diversified away from your typical [Bloomberg Barclays U.S. Aggregate Bond] index which is heavy on Treasuries and corporates. We've looked at fixed income markets where you can get some higher yields. We also like managers who can be opportunistic in terms of finding a little bit higher yield and who can adjust their allocations against a rising interest rate market.

Timothy Chubb
Courtesy of Girard Advisory Services

Timothy Chubb, chief investment officer at Girard Advisory Services: We're looking at some assets that ultimately let us hedge against interest rate risk. Think about them as dimmer switches. How much is appropriate in this environment?

One [example] is looking outside the U.S. We've become a more globalized economy. Having a portion in global bonds, especially in this environment, makes a lot of sense. There are global bond managers who will take a more conervative approach, but for our clients, going global has been an important part of rounding out that fixed income part of the portfolio.

[Bond funds] are a great way to access an area of the market and especially asset classes that the normal retail investor, who isn't capable of selecting those bonds on their own. Many managers can be strategic about it. Just buying a Barclays aggregate fund-like index... allocating to that and calling it a day might present more risk to an investor in a rising interest rate environment than they realize.

Eleanor Reid
Courtesy of Gideon Strategic Partners

Eleanor Reid, partner, Gideon Strategic Partners: Bonds still have a place, but it depends on a client's risk profile and their objectives. For instance, if you are an investor that is qualified, we recommend leveraged loans through private funds. But they are [for] those who have the tolerance and can fit into a more illiquid type of investment. You can't trade into it one day and out the next.

We started looking into [alternative] strategies a couple of years ago, and building out relationships with funds so that our clients who are high-net-worth individuals can get into these funds at lower minimums. We're able to get our clients in for the low six digits versus the millions of dollars these funds typically require.

The typical 60/40 portfolio isn't working right now as far as publicly traded bonds are concerned. So we're taking a very tactical approach for each client portfolio. We've reduced some public bond holdings in light of what has been happening in the market. It's been a tough balance. At the same time, you don't want to lose money when you go up against inflation.

Jim Besaw, chief investment officer at GenTrust: The main purpose for bonds is to act as an anchor for the risk side of your portfolio. If you remove them or replace them with illiquid strategies or strategies like high yield that are very correlated to equities, you lose

Jim Besaw
Courtesy of GenTrust

that diversification benefit. We look at bonds not just in terms of the yield they provide but in terms of the total value to the portfolio. Last year, not only did bonds make money in the down market environment, but you had the ability to sell them and rebalance and buy more equities, and the value of that rebalancing over time is somewhere on the order of 50 to 75 basis points.

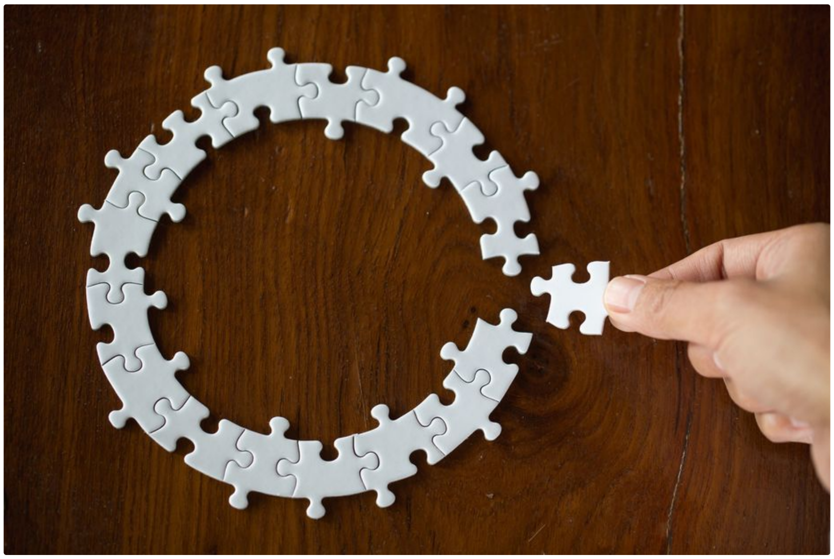
We’ve always been fairly strong advocates of municipal bonds because a lot of our clients are in the highest tax bracket, and it usually makes sense on an after tax basis to be invested in that asset class. Plus, historically municipal bonds had much lower default rates for similar quality credit to investment-grade fixed income.

The asset class within fixed income that we’ve been most in favor of since March of last year has been inflation-linked bonds. The value there is that back when we allocated a decent amount in March and April of last year, the market was forecasting inflation going forward at very low levels, somewhere below 1%. Given the increased fiscal stimulus, we thought inflation would become much more of a concern, which it has. I think those bonds still provide a decent amount of value.

Paul Burgon
Courtesy of Paul Burgon

Paul Burgon, managing partner of Lipman Burgon & Partners: We have zero government bond exposure. They offer negative real yields and little to no protection. This is despite the recent pullback in yields that we view as temporary. The pullback can be attributed to the Fed’s more hawkish tone in bringing forward to 2023 its estimate of the first rate hike and also technical factors, such as the rise in 10-year Treasury yields in January to March from 0.92% to 1.73% leading to oversold conditions.

As quantitative easing is unwound in the second half of this year through the tapering of central bank bond purchases, we very much expect yields to rise again and we do not advocate allocating capital to this asset class.



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