



What will my client earn on their bond portfolio

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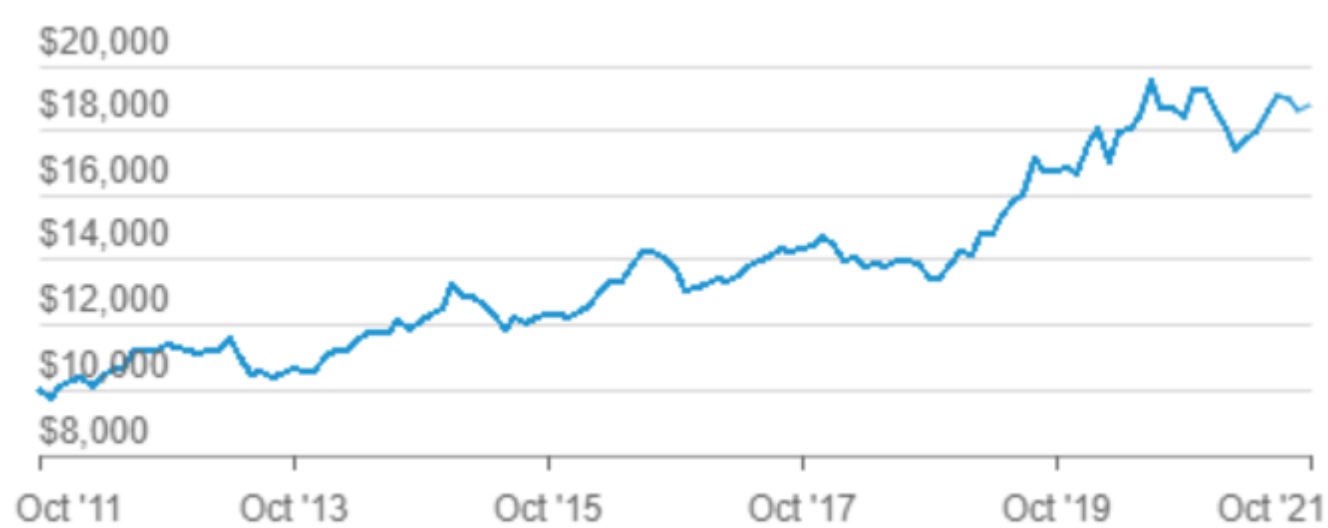
"I think that a life properly lived is just learn, learn, learn all the time"

Charlie Munger

- My client's past bond returns were fantastic
- Do past bond returns tell me anything about future bond returns
- Current yields . . . today
- Best possible forecast of future bond returns . . . and why
- Inflation . . . do I need to worry about rising inflation?
- But wait . . . it gets even worse
- Reasonable expectations
- Does this apply to bond tactical asset allocation . . . nope!

My client's past bond returns
were fantastic

Vanguard bond mutual fund



Add a fund or an ETF

Select a benchmark

Compare the growth of a hypothetical \$10,000 investment in this fund with the growth of the same amount in up to 2 other Vanguard funds and a benchmark. To get an accurate comparison, choose a time period that covers the number of years all funds have been in existence. Move your arrow or fingers across the chart to see specific dollar amounts.

Long-Term Invest-Gr Inv

Average annual returns—updated monthly
as of 10/31/2021

	1-yr	3-yr	5-yr	10-yr	Since inception 07/09/1973
Long-Term Invest-Gr Inv	2.28%	11.90%	6.51%	6.51%	8.33%

PIMCO High Yield Spectrum Fund Class I (PHSIX)

BUY COMPARE ADD TO WATCH LIST

Overview Price & Performance Portfolio & Management Fees & Minimums

Price

Current prices

Price as of 10/29/2021	\$10.03	
Change	\$0.00	0.00%
SEC yield as of 09/30/2021	2.93%*	
52-week high 09/16/2021 	\$10.18	
52-week low 10/30/2020	\$9.49	
Range	\$0.69	7.27%

Historical prices

10/29/2021	\$10.03
10/28/2021	\$10.03
10/27/2021	\$10.03
10/26/2021	\$10.03
10/25/2021	\$10.02

Search for more historical price information

Performance

Average annual returns—updated monthly as of 09/30/2021

	1 Year	3 Year	5 Year	10 Year	Since Inception 09/15/2010
PIMCO High Yield Spectrum Instl	11.15%	6.42%	6.37%	7.79%	7.04%

American Funds High-Income Trust Class F-1 (AHTFX) [NTF]

BUY COMPARE ADD TO WATCH LIST

Overview Price & Performance Portfolio & Management Fees & Minimums

Price

Current prices

Price as of 10/29/2021	\$10.52	
Change	-\$0.01	-0.09%
SEC yield as of 09/30/2021	3.19%*	
52-week high 09/15/2021	\$10.61	
52-week low 10/30/2020	\$9.62	
Range	\$0.99	10.29%

Historical prices

10/29/2021	\$10.52
10/28/2021	\$10.53
10/27/2021	\$10.53
10/26/2021	\$10.53
10/25/2021	\$10.53
Search for more historical price information	

Performance

Average annual returns—updated monthly as of 09/30/2021

	1 Year	3 Year	5 Year	10 Year	Since Inception 03/15/2001
American Funds American High-Income Trus	15.05%	6.90%	6.57%	6.40%	6.51%

Do past bond returns tell me
anything about future bond returns

When you get a new home mortgage

- Do you ask the banker what mortgages were charging over the last ten years
- Or . . . do you ask what the current interest rate is on today's mortgages
- What's the **WRONG** thing to do . . . look at the past
- What's the **RIGHT** thing to do . . . look at today's rate

When you get a new bank certificate of deposit (bank CD)

- Do you ask what bank CDs were paying over the last ten years
- Or . . . do you ask what the current rate is on today's bank CDs
- What's the **WRONG** thing to do . . . look at the past
- What's the **RIGHT** thing to do . . . look at today's current yield

NO . . . Past returns tell you NOTHING about future returns

- Let me walk this back
- 99% of the active bond portfolios are too passive to deliver anything other than the current yield
- Sure . . . they'll deviate a tiny bit . . . but that deviation will be so small as to be generally unnoticeable
- That leaves the remaining 1%
- These are the tactical asset allocators
- Those bond managers that make such gigantic shifts . . . that current yields are relatively unimportant
- These managers are going after capital gains instead of current yields

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And if current yields are 1.5%, which do you want to go after? Current yields or capital appreciation?

- These managers are going after capital gains instead of current yields

Current yields . . . today

Treasury Yields

NAME	COUPON	PRICE	YIELD
GB3:GOV 3 Month	0.00	0.04	0.04%
GB6:GOV 6 Month	0.00	0.06	0.06%
GB12:GOV 12 Month	0.00	0.12	0.12%
GT2:GOV 2 Year	0.38	99.74	0.51%
GT5:GOV 5 Year	1.13	99.70	1.19%
GT10:GOV 10 Year	1.25	97.14	1.57%
GT30:GOV 30 Year	2.00	100.75	1.97%

Treasury Inflation Protected Securities (TIPS)

✓

NAME	COUPON	PRICE	YIELD
GTII5:GOV 5 Year	0.13	109.34	-1.68%
GTII10:GOV 10 Year	0.13	110.86	-0.94%
GTII20:GOV 20 Year	2.13	150.30	-0.50%
GTII30:GOV 30 Year	0.13	112.20	-0.27%

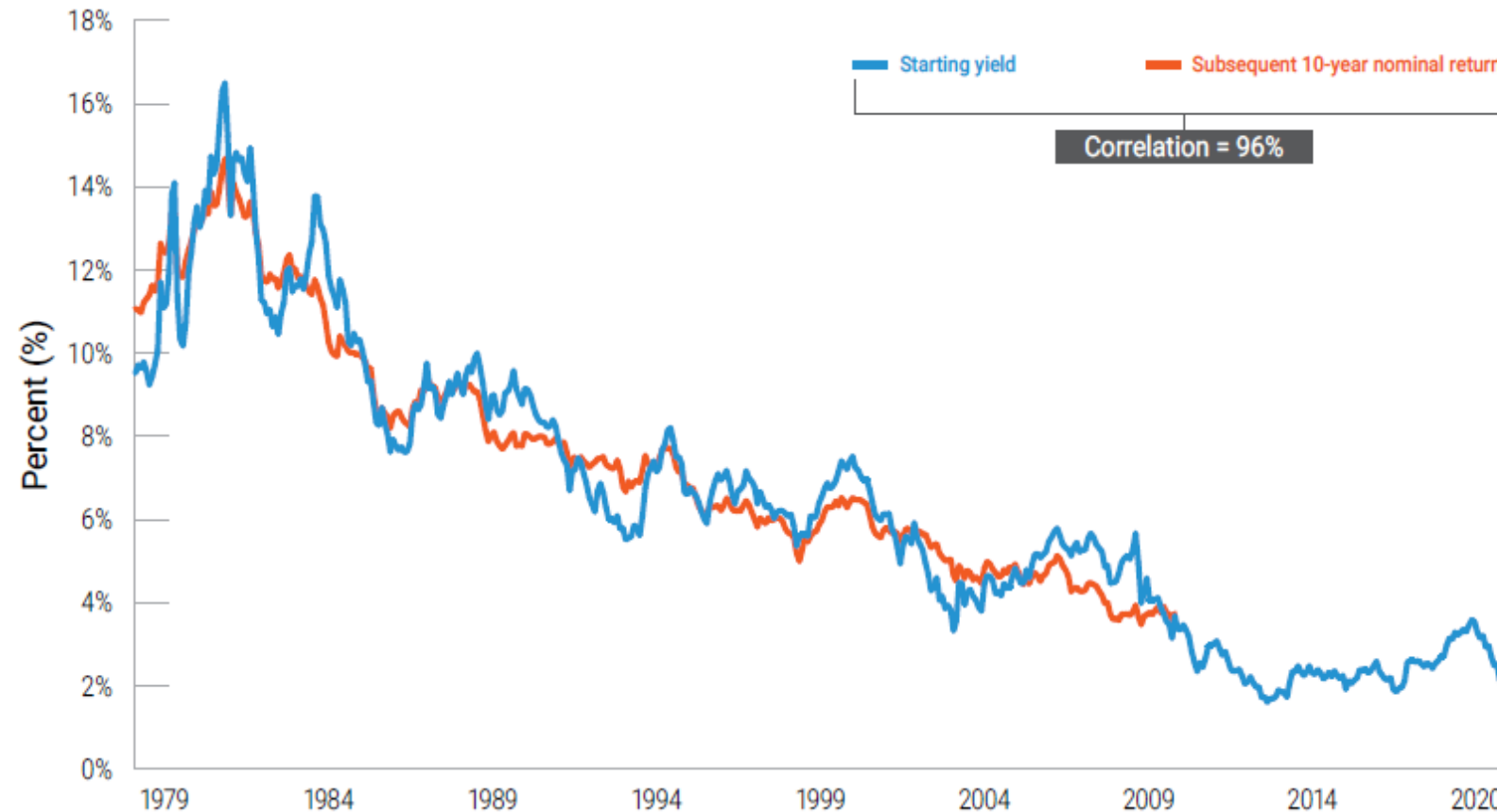
These yields
are all
negative

Best possible forecast of future bond returns . . . and why

Best possible prediction of what your client will earn !!!

Core bonds: Starting yields and subsequent returns

Bloomberg Barclays U.S. Aggregate Bond Index starting yield and subsequent returns



What is this chart showing?

This chart shows the starting yield of U.S. core bonds for the past 40+ years, along with the subsequent 10-year total return from that point.

Why is it important?

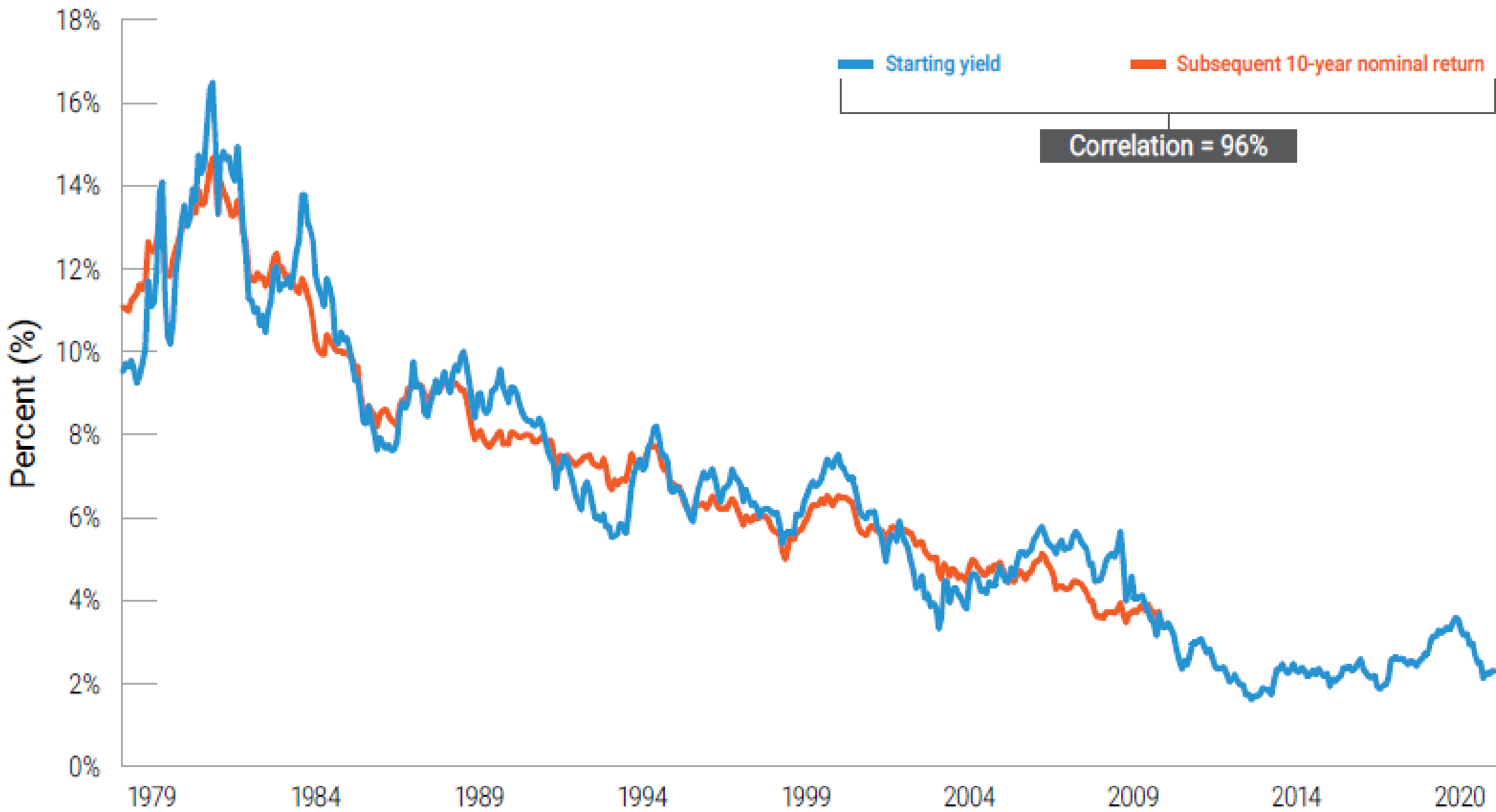
Investors commonly look to current yields to inform their total return expectations, as historically starting yield is an accurate predictor of future bond returns (96% correlation).

You cannot invest directly in an index. All indices are unmanaged and do not include fees or expenses. Please see the back of this brochure for index definitions and disclosures.

Source: Research affiliates based on data from Bloomberg and FactSet as of Dec. 31, 2020. Proxy: Bloomberg Barclays U.S. Aggregate Bond Index. **Past performance is not a guarantee or a reliable indicator of future results.**

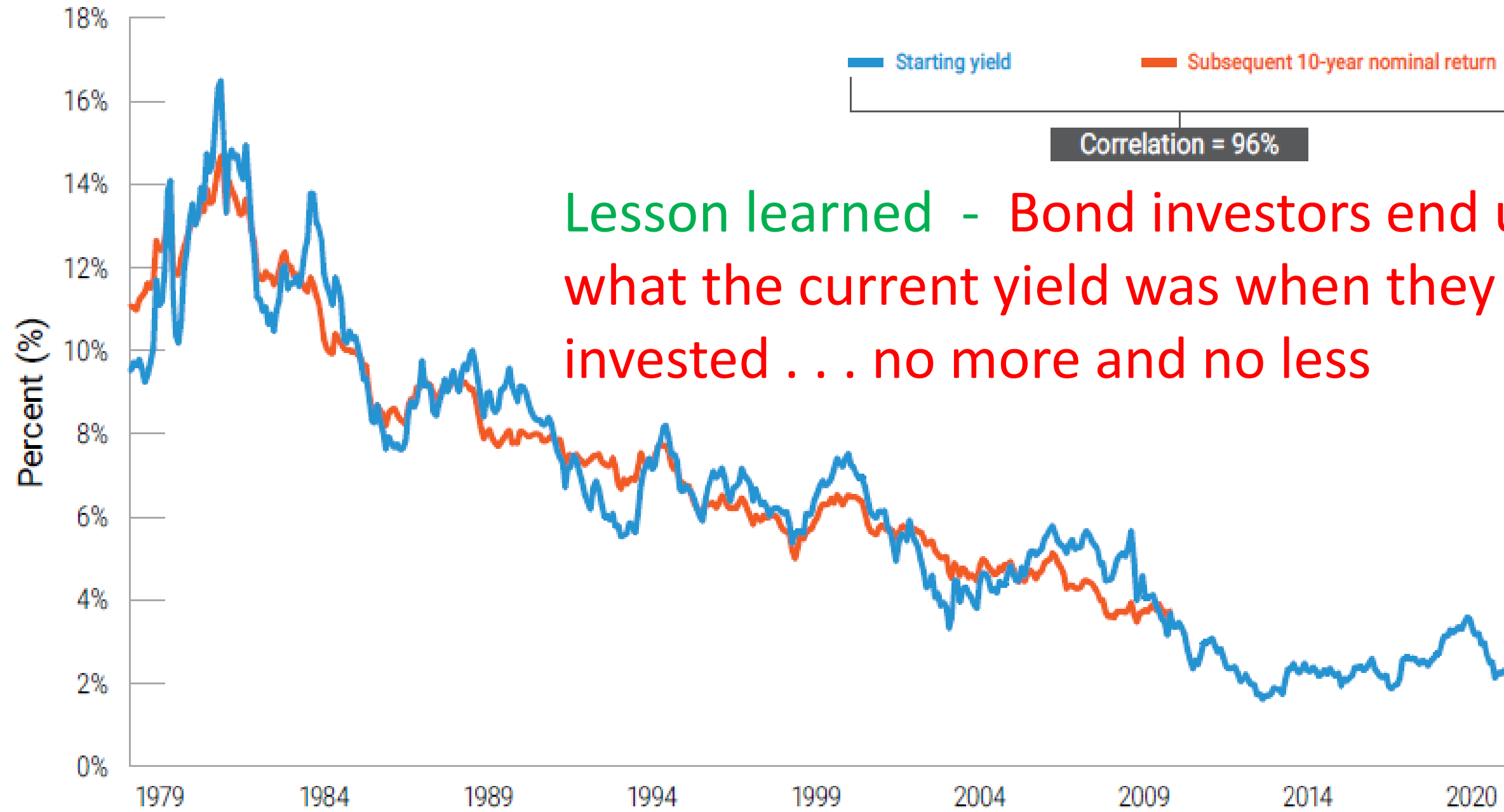
Best possible prediction of what your client will earn !!!

Bloomberg Barclays U.S. Aggregate Bond Index starting yield and subsequent returns



Best possible prediction of what your client will earn !!!

Bloomberg Barclays U.S. Aggregate Bond Index starting yield and subsequent returns



Lesson learned - Bond investors end up earning what the current yield was when they first invested . . . no more and no less

So what will your client earn if they hold US Treasuries??

Treasury Yields

NAME	COUPON	PRICE	YIELD
GB3:GOV 3 Month	0.00	0.04	0.04%
GB6:GOV 6 Month	0.00	0.06	0.06%
GB12:GOV 12 Month	0.00	0.12	0.12%
GT2:GOV 2 Year	0.38	99.74	0.51%
GT5:GOV 5 Year	1.13	99.71	1.18%
GT10:GOV 10 Year	1.25	97.17	1.56%
GT30:GOV 30 Year	2.00	100.81	1.96%

So what will your client earn if they hold TIPS bonds??

Treasury Inflation Protected Securities (TIPS)

NAME	COUPON	PRICE	YIELD
GTII5:GOV 5 Year	0.13	109.39	-1.69%
GTII10:GOV 10 Year	0.13	110.92	-0.95%
GTII20:GOV 20 Year	2.13	150.43	-0.50%
GTII30:GOV 30 Year	0.13	112.41	-0.28%

Plus the rate of inflation (because these are TIPS)

Inflation . . . do I need to worry
about rising inflation?

Inflation has risen to its highest level in over 30 years



Inflation has risen to its highest level in over 30 years



NO . . . Don't worry about inflation

- Inflation is temporarily being pushed up by
 - Supply chain disruption
 - Labor market imbalance
- Both of these are temporary short-term behaviors
- Both are already healing . . . and in the process of going away
- In fact, they may very well operate in reverse, serving to push prices back DOWN

YES . . . Future inflation could be pretty bad

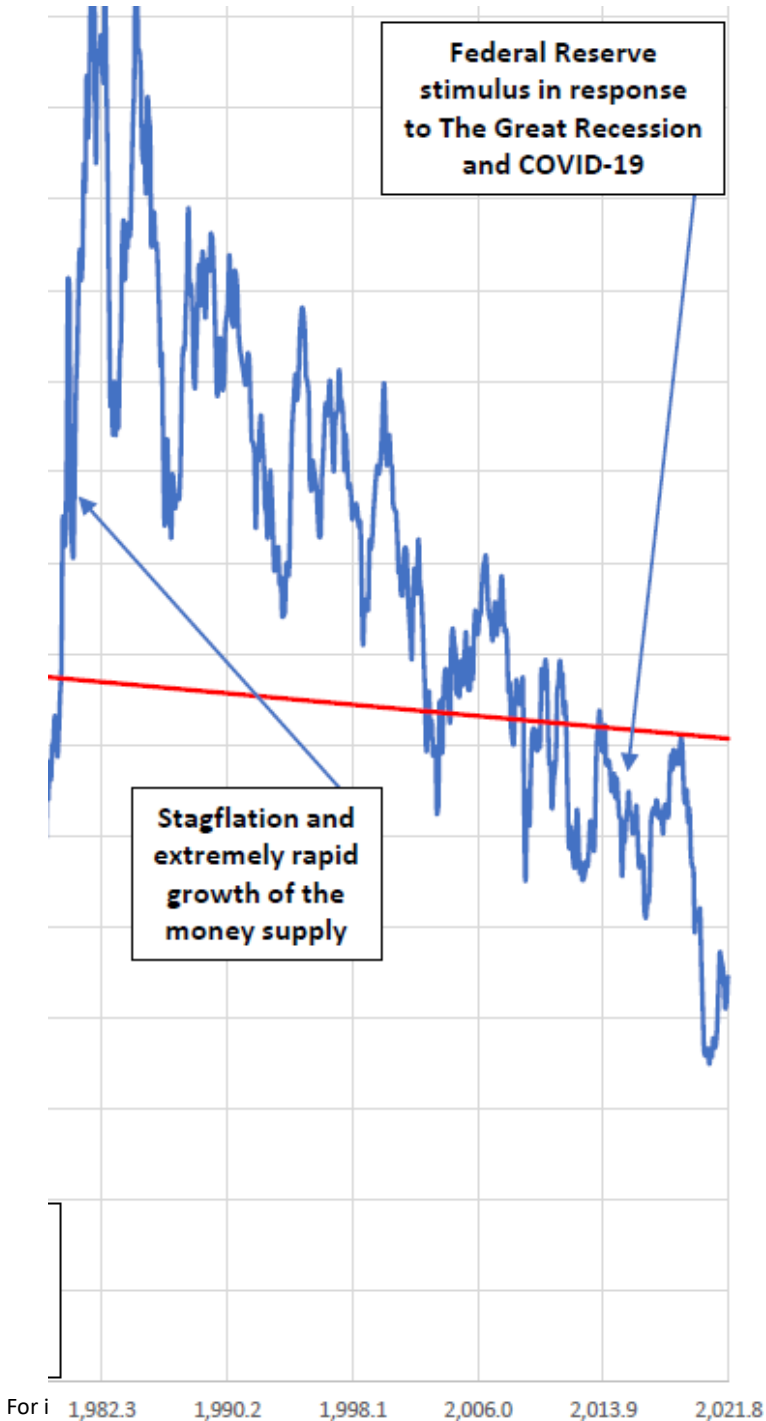
- End of cheap Chinese labor
- Shrinking US labor force due to immutable demographic patterns
- Global shift from fossil fuels to renewables
- New federal infrastructure bill . . . extra \$750 billion
- New federal social spending bill . . . extra \$1.7 trillion
- Excess savings held by US consumers . . . extra \$2.3 trillion
- Return of the velocity of money (how long people hold a \$Dollar in their wallets) back to its normal average historical level

But wait . . . it gets even worse

Where are interest rates right now . . . and can they stay there



Where are interest rates right now . . . and can they stay there



Where are interest rates right now . . . and can they stay there

1.54% Current nominal yield on a 10-year Treasury

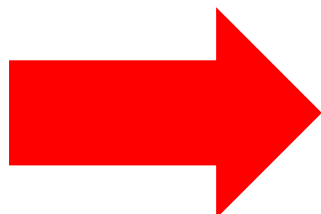
-0.95% Current yield after subtracting out expected inflation

1.11% Current trendline inflation-adjusted yield

89% Percentage of the time that inflation-adjusted yields are higher than they are today

17% Percentage of the time that inflation-adjusted yields are negative

-19% How much the 10-year Treasury bond would have to fall in price for rates to return to trendline (if change occurred overnight)



Bonds have ferocious bear markets . . . too

Bull markets for inflation-adjusted U.S. bonds since 1845

	Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BULL market
	184	17.58	Aug 1845	Mar 1863	5.3	70	6.1
	1075	43.08	Nov 1865	Dec 1908	3.5	75	5.9
	379	20.67	May 1920	Jan 1941	5.2	73	7.9
	26	7.75	Aug 1957	May 1965	2.6	70	3.0
	1008	38.83	Sep 1981	Jul 2020	6.8	61	6.4
Median BULL market	379	20.67			5.2	70	6.1
Mean BULL market	534	25.58			4.7	70	5.9

Bonds have ferocious bear markets . . . too

Bear markets for inflation-adjusted U.S. bonds since 1845

	Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BEAR market
	-22	2.67	Mar 1863	Nov 1865	6.1	31	-9.1
	-50	11.42	Dec 1908	May 1920	4.8	41	-5.9
	-31	16.58	Jan 1941	Aug 1957	3.3	45	-2.2
	-40	16.33	May 1965	Sep 1981	6.4	45	-3.0
	?	?	Jul 2020	?	?	?	?
Median BEAR market	-35	13.87			5.4	43	-4.5
Mean BEAR market	-36	11.75			5.1	40	-5.0

- We (and every other major nation) have always had Bond Bear Markets
- The vanilla, middle of the road, bond bear market delivers
 - -36%
 - Lasts 11.75 years

Reasonable expectations

- Inflation will return
- Interest rates (after adjustment for inflation) must rise, returning to a sustainable level
- Markets will overshoot . . . they ALWAYS do
- For political, social, geopolitical, economic, and societal reasons honking big indisputable reasons . . . the global developed world has embarked on an expansionary phase defined by an increased role for government, social programs, shifting priorities, and wealth redistribution
- This new direction . . . will serve to push interest rates and inflation higher for decades as opposed to years
- A traditional, vanilla, middle of the fairway bond bear market . . . is the only possible conclusion

- A classic bond bear market
- Check the numbers
- Check them for the US . . . And for the other major industrialized nations
- Bond bear markets have always been with us, always will, and for good reasons
- Bond bear markets are not fun

Does this apply to bond tactical
asset allocation . . . nope!

NO . . . Past returns tell you NOTHING about future returns

- Let me walk this back
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- My 2 cents (probably worth less than that)
- Here are the following solutions
- Stay ultra short interest rate duration
- Move out of bonds
 - Direct ownership of physical real estate (own a building)
 - True institutional quality alternative investments
- Go with an ultra-active, ultra-aggressive, mutual fund bond manager
 - These are serious rare !!!!
- Tactical Asset Allocation
 - Restricted to the fixed-income arena

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Time Segmentation Investing & Enhancing Client Behavior

Rob . . . moving from a detractor to an advocate

Friday, November 19th at 11:00 a.m. EASTERN

All data and statistics were provided by Global Financial Data, Inc. (unless otherwise indicated in the exhibit)

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