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The Alling Review

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Bond Investing Strategies

Bonds are an important part of a well-balanced portfolio. You should consider what bonds have to offer as well as strategies to build your portfolio.

Bonds Deliver Income

If you are looking for a reliable source of income, you should include bonds in your portfolio. Even when interest rates are low, there are a variety of bonds that provide higher returns, such as high-yield bonds and emerging market debt.

Bonds Offer Diversification

If you put all of your money into one asset class, such as stocks, your entire portfolio is at greater risk. By investing a portion of your portfolio in bonds, you will reduce your risk. Bonds can help you preserve capital when the stock market is experiencing volatility.

Bonds Preserve Principal

When you are getting closer to the time that you will need cash from your investments, such as within five years of retirement, you should move more money to fixed-income investments. The stock market can experience large losses over a short period of time, but your fixed-income investments are much less likely to experience large losses over the short term. Many investors increase their allocation to bonds as they move closer to their goals to preserve their principal.

Bonds Offer Tax Advantages

If you are trying to reduce your tax liability, certain types of bonds can help you meet this challenge. For example, the interest earned on municipal bonds is free from federal taxes, and if you own a bond issued within the state you live in, it will also be state income tax free. While taxes shouldn't be the only reason to invest in bonds, consider this as part of your overall financial plan.

Building a Bond Portfolio

Based on your goals and risk tolerance, there are many strategies for building your bond portfolio. Investors who are looking for income but don't want to be actively involved in portfolio management may want to employ a buy-and-hold approach. Investors who want more involvement, along with security and predictability, may want to look at index matching and immunization strategies. For investors who

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Assessing Your 401(k) Plan

At least annually, you should thoroughly review your 401(k) plan. Some items to consider include:

- **Have your goals or objectives changed?** Most people use their 401(k) plan to fund retirement. Take time to reassess your goals and objectives, which can impact how much you contribute and how you invest those contributions. Calculate how much you'll need at retirement as well as how much you should save annually to meet that goal.
- **Are you contributing as much as you can to the plan?** Look for ways to increase your contribution rate. One strategy is to allocate any salary increases to your 401(k) plan immediately, before you get used to the money and find ways to spend it. At a minimum, make sure you are contributing enough to take full advantage of any matching contributions made by your employer. In 2019, the maximum contribution to a 401(k) plan is

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Bond Investing

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want to actively manage portfolios, search for higher returns in exchange for higher risk.

Consider the following bond strategies to determine what strategy would be most comfortable for you. The four primary strategies are:

1. Passive Bond Strategy

With a passive bond strategy known as buy and hold, you are buying individual bonds and holding them until maturity. The bond's coupon rate is the amount of interest income earned each year based on the face value of the bond, and its yield is the estimated rate of return, assuming it is held until its maturity date. The cash generated by bonds can be used for income needs or be reinvested into other bonds or even other asset classes.

Unlike more active strategies, the buy and hold investor does not actively deal with the future direction of interest rates, nor is he/she focused on the current value of the bonds due to changes in the yield. The assumption is that full par value from the bond will be received upon maturity.

Because of the investor's minimal involvement, passive bond portfolios provide stability during market volatility. The primary reason for this is that the strategy invests in very high-quality, non-callable bonds, such as government or investment-grade corporate or municipal bonds.

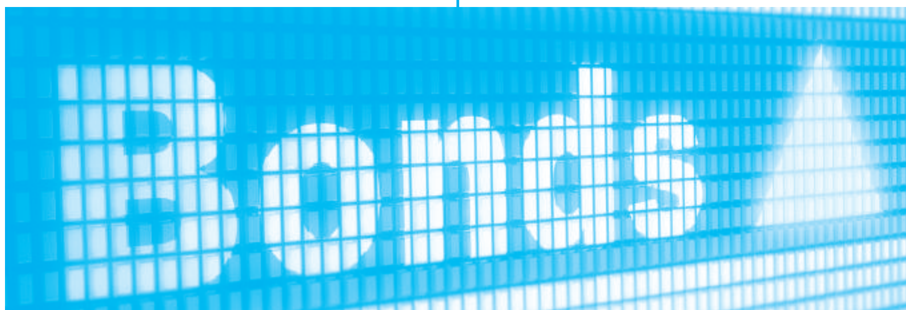
Bond laddering is probably the most common form of passive bond investing and provides a steady income stream. The idea of a bond ladder is simple: instead of investing in bonds that mature at roughly the same period of time, or in a haphazard pattern of maturities, you spread your portfolio out in roughly equal amounts over maturities that are evenly separated from one another. Ideally, all of these bonds are from the same issuer or from issuers with the same credit quality. When a bond matures, the principal is reinvested at the bond ladder's longest maturity date.

If interest rates are higher then, your annual bond income will go up; if rates go down across the board, your income will still benefit from the relatively higher rates on the rest of your portfolio. In either case, because most of your portfolio is still throwing off the same cash flow, your annual income won't change much, which makes your income more predictable than if all of your bonds matured in any single year.

2. Indexing Bond Strategy

An indexing bond strategy is what is known as a quasi-passive strategy. The primary objective is to provide similar return and risk characteristics of a particular index. It is similar to tracking a specific stock market index, as a bond portfolio can be structured to copy a published bond index. Probably one of the most well-known and widely used bond indexes is the Barclays Capital U.S. Aggregate Bond Index. Using this works best with a large bond portfolio due to the number of bonds that need to be purchased to replicate it.

While this strategy is comparable to a buy-and-hold strategy, it does offer some flexibility, as the portfolio can be rebalanced to reflect changes in the index.



If you invest using an indexing strategy, you need to be aware that there are transaction costs associated with the original investment as well as when the portfolio is periodically rebalanced.

3. Immunization Bond Strategy

With characteristics of both active and passive, the immunization bond strategy invests a portfolio for a defined return for a specific period of time regardless of potential influences, such as changes in interest rates. The immunization strategy is for the investor who is willing to give up potential gains for the assurance that the portfolio will achieve its desired returns.

This strategy is often used in institutional investing, when companies need to ensure they have a certain amount of cash flow to meet their liabilities at a certain period of time, but it is also an effective strategy for individuals.

The immunization strategy is best used with high-grade bonds that have a remote possibility of default or with zero-coupon bonds. Zero-coupon bonds match the maturity of the bond to the date the funds are needed.

4. Active Bond Strategy

An active bond strategy is about maximizing total returns. Investments are actively managed based on the anticipation of interest rate changes, credit changes, and valuation changes. The premise of active strategies is investors are making investments based on what the future will bring.

For example, the active strategy investor would buy bonds with longer maturity durations in anticipation of lower long-term interest rates, buy junk bonds in anticipation of economic growth, or buy Treasuries when the Federal Reserve is expected to increase the money supply.

Please call if you'd like to discuss the role of bonds in your investment portfolio. ❍❍❍

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401(k) Plan

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$19,000 plus an additional $6,000 catch-up contribution, if permitted by the plan, for individuals age 50 and older.

- **Are the assets in your 401(k) plan properly allocated?** Some of the more common mistakes made when investing 401(k) assets include allocating too much to conservative investments, not diversifying among several investment vehicles, and investing too much in the employer's stock. Saving for retirement typically encompasses a long time frame, so make investment choices that reflect that time period. For many, that means a significant portion of their assets should be invested in growth vehicles.
- **Do your investments need to be rebalanced?** Use this review to ensure your allocation still makes sense. Also review the performance of individual investments, comparing the performance to appropriate benchmarks. You can't just select your investments once and then ignore the plan. Review your allocation annually to make sure it is close to your desired allocation. If not, adjust your holdings to get your allocation back in line. Selling investments within your 401(k) plan does not generate tax liabilities, so you can make these changes without any tax ramifications.
- **Are you satisfied with the features of your 401(k) plan?** If there are aspects of your plan you're not happy with, such as too few investment choices or no employer matching, take this opportunity to let your employer know.

Managed properly, your 401(k) plan can play a significant role in helping to fund your retirement. Please call if you'd like help reviewing your 401(k) plan and investments. ❍❍❍

Give Yourself a Money Makeover

You know what it's like: whether it's a result of a big life change or you just need to shake things up, it feels like it's time for a makeover. But instead of swapping long tresses for a pixie cut, this kind of makeover is one that will outlast changing trends and you'll always thank yourself for — a money makeover.

The first step is to figure out what isn't quite working for you. You wouldn't sit for a haircut without indicating what you want changed about your hairstyle, so you also need to determine the flaws in your money strategy before you can change it.

This means you will need to make an honest, objective assessment of your financial circumstances and list what you wish was different. For example, you may notice that you routinely carry a balance on your credit cards and end up paying a lot in interest. You would rather have that money to save or invest, so your wish is that you would stop carrying balances on credit cards. In this process, you will likely have to deal with some things that reflect parts of you that you do not like, but take care to be honest while not overly berating yourself about your shortcomings.

Step number two involves narrowing your wish list down to smaller, fixable bites. You can't snap your fingers and change everything at once, so you will need to choose what to focus on first. Look over your list and highlight a few items that could make a big difference and are within your grasp, such as taking intentional steps to improve your credit score or committing to a strict monthly budget.

The next step is taking action. You will need to actually implement changes and stick to them. This is difficult, so it is helpful to make sure you have written down the measures you want to take and given yourself a timeline to follow. When a goal is fairly large, you may want to create milestone targets on the way to reaching it. This can help you keep better track of your progress and prevent the ultimate goal from seeming too overwhelming.

The final step can sometimes be the first step: get help. If you are in over your head (or have more complex goals, like retirement, estate, or tax planning), then seeking professional advice should be your first step. But even if you have chosen to go it alone, having someone in the loop to keep you accountable can be the difference between success and failure.

It can be easy to focus on all of the bad choices you have made in the past, but it's important to remember to celebrate the progress you are making now. Every little step counts, whether it's automatic contributions to savings, clearing your consumer debt, or just following your budget — make sure you acknowledge the good things you are doing in this money makeover. ❍❍❍

Financial Data

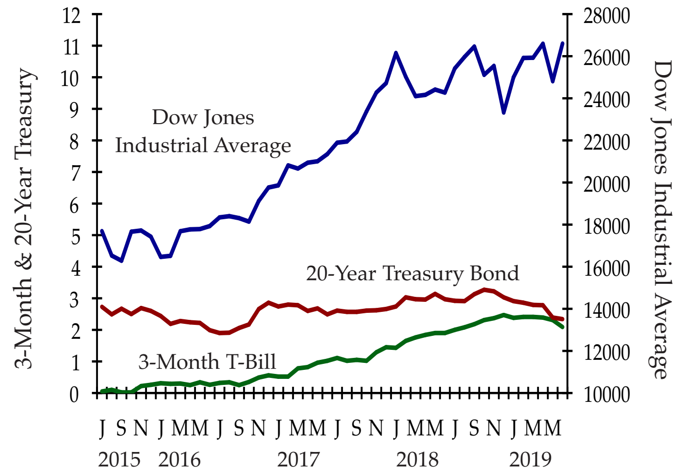
Indicator	Apr-19	May-19	Jun-19	Dec-18	Jun-18
	Month-end				
Prime rate	5.50	5.50	5.50	5.50	5.00
Money market rate	0.65	0.72	0.69	0.56	0.52
3-month T-bill yield	2.39	2.31	2.09	2.47	1.90
20-year T-bond yield	2.78	2.39	2.34	3.03	2.97
Dow Jones Corp.	3.74	3.63	3.22	4.40	3.94
30-year fixed mortgage	3.75	3.44	3.14	4.16	4.52
GDP (adj. annual rate)#	+3.40	+2.20	+3.10	+2.20	+2.20

Indicator	Apr-19	May-19	Jun-19	YTD	12-Mon.
	Month-end			% Change	
Dow Jones Industrials	26592.91	24815.04	26599.96	14.0%	9.6%
Standard & Poor's 500	2945.83	2752.06	2941.76	17.3%	8.2%
Nasdaq Composite	8095.39	7453.15	8006.24	20.7%	6.6%
Gold	1282.30	1295.55	1409.00	9.9%	12.7%
Consumer price index@	254.20	255.55	256.09	1.6%	1.8%
Unemployment rate@	3.80	3.60	3.60	-2.7%	-5.3%

\# — 3rd, 4th, 1st quarter @ — Mar, Apr, May Sources: *Barron's, Wall Street Journal*

4-Year Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield

July 2015 to June 2019



Past performance is not a guarantee of future results.

News and Announcements

Bond Investing Tips

Consider the following bond investing tips:

- **Determine your objectives before investing.** Decide how much to invest in bonds.
- **Diversify your bond holdings among different bond types.** Consider government, corporate, and municipal bonds, as well as different industries, credit ratings, and maturities.
- **Understand the risks that affect bonds.** The most significant is interest rate risk. When interest rates increase, bond values fall, while values rise when interest rates decline. Other risks include default risk and inflation risk.
- **Choose bond maturity dates carefully.** When you need your principal is a major factor, but the current interest rate environment may also affect your decision. You may want to ladder the maturity dates.
- **Follow interest rate trends.** At a minimum, follow the prime rate, Treasury bill rates, and Treasury bond rates. Understand the significance of the yield curve and track its pattern over time.
- **Compare interest rates for specific bonds before investing.** Interest rates can vary substantially among different bond types and among bonds with different maturities or credit ratings.
- **Research a bond before purchase.** Review the credit quality, coupon rate, call provisions, and other significant factors.
- **Consider the tax aspects.** By comparing the after-tax rate of return for various types of bonds, you may be able to increase your return.
- **Review your bond holdings periodically.** Evaluate the credit ratings of all your bonds at least annually to ensure the quality hasn't deteriorated. Also, ensure your holdings are still consistent with your overall investment objectives. ❍❍❍ FR2019-0321-0041

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