# Fixed Income: Keep it Safe and Stable

## By Frank Garcia

The ingenuity of brokerage firms and mutual fund managers never ceases to amaze us. Every time we blink an eye, a new type of hedge fund or mutual fund enters the market with a well-thought-out name, promising to be the next great investment opportunity. This is particularly true when it comes to bond funds, sometimes referred to as fixed-income funds. These products often have names specifically designed to be vague and make them sound extremely attractive to own.

Some examples of these creative fund names are the Goldman Sachs Enhanced Income Fund, J.P. Morgan's SmartAllocation Income Fund, and Pimco's Unconstrained Bond Fund, all three of which charge over 1.5% in initial purchase fees![1]

In our view, the purpose of fixed income in an investment portfolio is simple: increase diversification, reduce volatility, and earn enough return to preserve buying power.

Many investment advisors include exotic fixed-income funds in their clients' portfolios along with long-term and low-quality bonds (a more attractive name for what is commonly referred to as "junk bonds"). While these investments can provide additional return to a portfolio, they also add a significant amount of risk to the portion of your portfolio that is supposed to be "safe money." During the 2008 financial crisis, junk bonds dropped 26% while investment-grade bonds increased 5%, providing the safety and stability needed during market downturns.[2]

These investments are also particularly risky in a rising-interest-rate environment like we face today. Bond values are inversely related to interest rates, meaning that they move in opposite directions. When rates go up, bond values go down. With the Federal Reserve raising interest rates for the first time in almost 10 years, long-term, low-quality bonds is the last place an investor would want to park their "safe money."

**What is RCG's approach to fixed income?**

One difference between our investment philosophy and that of typical investment advisors is our approach to fixed income. We use short-term, high-quality bond funds exclusively. They are typically quite resilient in a rising-interest-rate environment. The biggest drawback to this type of fixed income is it has lower yields than long-term, low-quality bond funds. Yield is directly related to risk: the reason they do not yield as much is that they are less risky.

Our bond allocation is specifically designed to provide stability and reduce volatility regardless of the Fed's actions and interest rate changes. This is not to say our fixed income funds cannot lose value. Just like any investment, there can be losses. However, if they do lose value, it will not be of the same magnitude as long-term, low-quality bond funds.

Only if the Federal Reserve raises interest rates significantly over a very short period would a meaningful loss of value occur. If the Federal Reserve were to take that type of action, short-term, high-quality bonds will be a substantially safer place to invest than long-term or low-quality bonds.

While the Fed's raising of interest rates is a positive economic signal, the extent and effect is impossible to predict. After one of the slowest economic recoveries since the 1920's, the Fed is finally sending the market a signal that the economy appears to be ready to operate without substantial support from monetary policy.

**What should you do?**

Stay disciplined. This is one of the best things you can do to ensure investment success. Changing your investment strategy based on the actions of the Fed is akin to market timing. To successfully time the market, or in this case time interest rate expectations, you need to correctly predict four items in order:

- What to sell
- When to sell
- What to buy
- When to buy

Incorrectly predicting even one of these four items can have detrimental effects on the long-term success of an investment portfolio. Similarly, investing in fixed income to generate higher income instead of to provide stability, can have a negative impact on long-term investment success.

As we have shared many times, our investment philosophy is based on academic research, not Wall Street's predictions. We prefer to follow an evidence-based investment philosophy that will place our clients in the best position to achieve their long-term investment goals.

So, let the brokerage firms, hedge funds, and mutual fund companies come up with all the fancy names they want for their funds. Rest assured that RCG will not be swayed by these sales ploys. As Paul Harvey was famous for saying, "Now, you now know the rest of the story!"

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[1] Fees referenced are associated with the initial sales charge (load) imposed on purchasers as a percentage of offering price when purchasing A shares.

[2] Data provided by Bloomberg. Indices listed are Bloomberg Barclays U.S. Corporate High Yield Index and the Bloomberg Barclays U.S. Government/Credit Index 1-3 years respectively.

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