

Exiting Bonds When Interest Rates Rise Can Be A Big Mistake



It's a completely understandable reaction.

When current interest rates rise, bond prices go down. Some "investors" suddenly become more like traders and run to their computers to sell off their bond funds before they can lose any more value. After all, cutting your losses only makes sense, right?

Unfortunately, this "common sense" reaction can end up costing those investors much more than if they'd stayed committed to a longer term strategy. Depending on the maturity dates in their bond portfolios, the longer they'd held on to them after the interest rate jolt, the closer they'd be to pre-decline price levels.

To understand why, you first have to remember the counterintuitive nature of bonds.

The Upside Down World Of Debt Instruments

Bonds, of course, are instruments of government and corporate debt issued to raise money. Their total returns come from two sources: a change in their price and their coupon income.¹

The first, their change in value, is usually negatively affected when interest rates rise. This is because the new bonds being issued with the higher declared interest rate make the older bonds with lower declared interest rates worth less by comparison.

The second, their set payout, remains unaffected by interest rates. Unless a company that issued the bonds goes into default (a fairly rare occurrence for high-quality bonds), the bond will continue to pay its dividend until maturity. This is very different from the absolutely unknown future performance of a stock.

The bonds in your bond fund, which may have declined in value in the short-term because of rising rates, will tend to drift back to par (their original value) as they reach maturity.

And even in our recently-observed rising interest rate environment, the short-term losses have been modest.

Writing for MarketWatch, Cullen Roche explains that if you bought an aggregate bond fund one year ago, you were buying an instrument that paid about 2.25% with an average effective maturity of roughly 5.9 years. Rising rates since then have resulted in a 3.11% principal decline since then, leading to a current total return of -0.86%.²

But if you hold onto that fund, things begin to turn around.

The characteristics of the bonds you hold also have an impact on their price volatility. Bond portfolios with higher average maturities have higher expected duration. Duration is a measure of the expected decline in a bond's price in response to an increase in yields (interest rates). One of the reasons Efficient Advisors focuses on maintaining bonds with higher average quality and *lower* average duration is to help minimize the short-term impact of interest rate changes.

Turning A Short-Term Loss To A Long-Term Gain

The index in Roche's example begins to take off again as investors hold on long enough for the bonds to mature and be replaced with the higher yielding instruments. Again, discipline and the long-term view is the key.

Bonds' historical performance during times of stock volatility can make them an essential part of a diversified portfolio strategy seeking to offset the significant volatility expected in stocks. But that doesn't mean bonds always do something different than stocks, always go up or cannot temporarily decline in current value.

Similar to other asset categories in a broadly diversified portfolio, attempting to get in and out of bonds at just the right times is nearly impossible. Like other investments, bonds will likely become an underperforming asset category in the long run if you try to time their buying and selling with market or interest rate events—variables that have already been taken into account by the market.

Maintaining discipline with your expectations about bonds is key. While bonds' overall expected price volatility (risk) is historically less than that of stocks, there's still no free lunch. Risk and return are related, whether we're considering bonds or stocks in a portfolio.

If you have questions about the role bonds may play in your long-term retirement goals, talk to us.

Have a great weekend!

Golf Tip of the Week



The Top Golf Fundamental: The Grip

The simple truth: Good shots in golf depend on proper club grip.

Although top golf coaches sometimes give elaborate instructions on the best grips, Michael Jacobs makes it easy. Jacobs is an instructor at Rock Hill Country Club in Manorville, New York, and is listed among the 50 top golf teachers in America by *Golf Digest*.

“Stick out your left (weaker) hand and hold the club like you would a heavy suitcase,” Jacobs wrote in his book, *Elements of the Swing*.

“If you picked up a suitcase, you wouldn’t take the handle diagonally across your palm. You’d let it rest in the creases of your fingers where they attach to your palm.”

Golfers should then place their right (dominant) hand on the grip with their palm up and with the handle running along the top crease in the palm. Curl fingers around the underside. Rest the little finger of the right hand on either the left forefinger or between the forefinger and middle finger.

“Not every ‘classic’ golf tip you hear is necessarily still relevant now, but this one is still true. There’s no reason not to have a great grip. If you start with a bad one, you’re going to have to make compensations in your swing from the beginning.”

Tip adapted from Golf Digest¹

Recipe of the Week

Skillet Cookie Sundaes



Serves 8

Ingredients:

Graham Cracker Layer

6 tablespoons unsalted butter, melted and cooled
1/4 cup granulated sugar
1 1/2 cups graham cracker crumbs (from 12 sheets)
3/4 cup semisweet chocolate chips

Cookie Dough Layer

1 cup loosely packed dark brown sugar
3/4 cup (1 1/2 sticks) unsalted butter, melted and cooled
1 tablespoon pure vanilla extract
1 large egg plus 1 egg yolk
1 1/2 cups all-purpose flour
3/4 teaspoon baking powder
1/2 teaspoon kosher salt
1/2 cup sweetened shredded coconut
1/3 cup semisweet chocolate chips
Ice cream, for serving

Directions:

Preheat oven to 350°F.

Graham Cracker Layer: Put melted butter and granulated sugar in a medium bowl and mix together. Mix in graham cracker crumbs until moistened. Press the mixture into the bottom of either a 10" cast iron skillet or eight 5" miniature skillets. Spread chocolate chips over the graham cracker crust.

Cookie Dough Layer: Whisk brown sugar and melted butter together in a large bowl. Add vanilla, egg, and egg yolk. Mix until combined. Put in flour, baking powder, and salt. Also mix until it is fully combined. Add coconut and chocolate chips and stir.

Spread the cookie dough evenly over the graham cracker crust. Bake until the cookie dough gets gooey in the middle and golden brown on the edges, 25-30 minutes. Take out of the oven and let it cool slightly. Serve with ice cream and toppings.

Recipe adapted from Good Housekeepingⁱⁱ

Health Tip of the Week



Water: the Elixir for Healthy Living?

Fruits, vegetables, exercise, fresh air, adequate sleep, and plenty of water. They're all good for healthy living, right? While fitting adequate exercise, sufficient sleep, and healthy foods into our daily routines can be challenging, nearly everyone has taken up the call to drink lots of water.

So, what's the scoop on water? Why is it so important?

Some medical authorities say the widely cited rule about drinking at least 8 glasses of water per day is a guideline and is not based on scientific evidence.

But wait, health experts say. Don't put down that water bottle yet.

"Think of water as a nutrient your body needs that is present in liquids, plain water, and foods," said Joan Koelemay, a dietitian for the Beverage Institute.

Here are 5 reasons to make sure you're getting your daily water intake:

1. **Drinking water maintains your body fluid balance.** Your body is 60% water. "Through the posterior pituitary gland, your brain communicates with your kidneys and tells it how much water to excrete as urine or hold onto for reserves," said Dr. Steven Guest, a nephrologist with Oakland, California-based Kaiser Permanente.
2. **Drinking water may help you lose weight.** Compared to other drinks, water has no calories.

3. **Drinking water gives your muscles energy.** “When muscle cells don’t have adequate fluids, they don’t work as well and performance can suffer,” Guest said.
4. **Drinking water improves the look of your skin.** “Dehydration makes your skin look more dry and wrinkled, which can be improved with proper hydration,” said Dr. Kenneth Ellner, an Atlanta dermatologist.
5. **Drinking water helps your kidneys.** “Your kidneys do an amazing job of cleansing and ridding your body of toxins as long as your intake of fluids is adequate,” Guest said.

Tips adapted from WebMDⁱⁱⁱ

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1. <http://go.efficientadvisors.com/e/91522/news-10093437/5kp27v/478879465>
2. <http://go.efficientadvisors.com/e/91522/ds-are-rising-2018-05-16-print/5kp27x/478879465>**Disclosure:**

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ⁱ <https://www.golfdigest.com/story/fix-your-grip-by-the-weekend>

ⁱⁱ <https://www.goodhousekeeping.com/food-recipes/dessert/a47671/skillet-cookie-sundaes-recipe/>

ⁱⁱⁱ <https://www.webmd.com/diet/features/6-reasons-to-drink-water#1>