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Wealth Management

HOW SAFE ARE MY BONDS?

The recent volatility in the stock market, and the fear and uncertainty that accompanies it, has prompted some investors to question the safety of their bond portfolio. Therefore, we would like to share with you our thoughts on your bond investments, and the steps ASI has taken to address such concerns.

The biggest risk for bond investors is the issuer of the bond (or lendee) cannot pay back the loan. Consequently, that bond is now worthless; this is referred to as a 'default.' We are proud to say that ASI has never had an individual bond default in a clients' account. ASI hires bond managers with proven track records during both up markets and down. We utilize the expertise of these managers to not only monitor the overall bond market, but more importantly to monitor the ongoing creditworthiness of the bond issuers themselves.

Recently, we have seen volatility in the pricing of some bonds. The price dislocation over the last week was prompted by many investors looking to sell their bonds in a very short period. Presently, investors are motivated to sell bonds for different reasons. Rational ones include clients' need to make tax payments, rebalance their portfolios by selling bonds and buying stocks, or simply to take money out of their portfolio to pay their bills and live their lives. But concerns over the economy and the impact that will have on bond issuers' ability to make interest payments and repay the loan is in the headlines frequently. In the absence of prudent credit research, this is a real concern.

It is important to remember that the purchase price of a bond dictates the rate of return you will receive as an investor, so long as the bond is held to maturity and the bond issuer pays back the loan. Price volatility does not affect this return. But managers may not hold every bond they purchase to maturity. They may sell a bond if they believe they can improve your position as an investor. Maybe they can get a higher-yielding bond at a similar price with similar risk, or maybe a bond is temporarily mispriced in the market and they want to take advantage of the opportunity. Possibly they want to take advantage of a change in rates or be more defensive given the economic outlook going forward. There are any number of reasons why our bond managers make trades, and they are all intended to benefit you, the client.

Bond volatility is not stock volatility. In a bad year, bonds may be down 3-5%, not 20-30% like stocks. Bond managers add value by doing the research and monitoring the entities to whom they are loaning your money. The financials of these companies or municipalities do not change quickly and if they were to deteriorate the manager would, and should, sell the bond before there was a threat of default.

We have had multiple phone calls with our bond managers, reviewing portfolios and discussing with them how they are approaching the current events as they unfold. They have assured us that they are not concerned with the underlying creditworthiness of the bonds they hold. They are diligently monitoring the economy, the bond market, and the bonds in our clients' portfolios, and will continue doing so—as always.