Insights Live℠

Bond investing in today's markets

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TRANSCRIPT

SPEAKERS:

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SUZIE ALLEN: Hello, and welcome to the latest *Insights Live*℠: Bond investing in today's markets. I'm Suzie Allen, Vice President of *Insights from Fidelity Wealth Management*℠. Thank you for joining us today, and thank you for submitting questions. It really helps shape our discussion. As you know, bonds can play a critical role in helping you gain income and stability in your portfolio. Today, we'll be doing a deep dive into this important asset class, covering everything from how different types of bonds work to what to expect in today's inflation and interest rate environment.

We have a lot to cover today. But before we get going, I want to let you know, Fidelity does not give tax or legal advice, and nothing we discuss today should be interpreted as tax or legal advice. The information we are providing is going to be general in nature, and it may not apply to your situation. If you have legal or tax questions about your specific situation, we encourage you to talk to your attorney or tax professional.

OK. Let's get started. I'm excited to introduce this amazing team of professionals from Fidelity who are here with us today. I'll ask everyone to introduce themselves and briefly describe their role here, and the perspective they bring to this discussion. So, Matt, let's start with you.

MATTHEW CRANE: Thanks, Suzie. Hi. My name is Matt Crane. I'm a Financial Consultant at Fidelity. I've been here in my current role for about 13 years now. I live in Salt Lake City, Utah, home of the 2034 Winter Olympics, and I work directly with some of Fidelity's high-net-worth clients located all throughout the country. I help them create financial plans, including how to invest, how to take income from their portfolio, as well as how to protect their assets.

SUZIE: Matt, thank you for joining us. Christine, how about you?

CHRISTINE THORPE: Sure. Well, hi, everyone. Great to be here. I'm Christine Thorpe, an Institutional Portfolio Manager for Fidelity's fixed income managed accounts. I'm based in Merrimack, New Hampshire, which is where we manage about 2 trillion in fixed income strategies. And really, in my role, I'm responsible for sharing our team's market insights and how we're positioning portfolios with our clients.

SUZIE: All right. Richard, last but not least.

RICHARD CARTER: Thank you. Hi, Suzie. Hi, everybody. My name is Richard Carter. I work in our Fidelity brokerage organization, responsible for our fixed income offering that you see online. That's the ability to allow our customers to buy and sell bonds and CDs on the website. So I hope I can offer that perspective of trends we're seeing there through our website, and also through the conversations our customers are having with our associates who help support that offering.

SUZIE: Great. Well, let's jump in. So may I say, it's been a tough few years for bond investors. And here's a question we get a lot. Matt, I'll pose it to you. Why bonds?

MATTHEW: Yes, Suzie, it has been tough indeed. And I like how you prefaced that question. Let me first address that sentiment that the bond market has been a tough place to invest, because there's no denying that it's been a rough go for over a decade, really, if you're looking at it. So I hear it all the time from investors. Why would I invest in bonds when they've been so bad for so long? Couldn't I just put that money in cash? Or why not just buy some stocks, because stocks have been doing so well?

And my answer is that sometimes as an investor, you have to think as a contrarian. For example, there's the saying that everybody knows—"buy low, sell high." It sounds good, but it's actually really difficult to execute, and it takes a lot of discipline. So it forces you to think objectively, not get distracted by recency bias, where you fall in love with just the things that have been doing really well.

I talk to investors all the time that—we'll review a portfolio. They will identify an investment, whether it's a stock or a bond, and it's down. And they'll say, I want to sell it because it's down, and therefore, it's bad. And I know it might sound silly saying that out loud, but it's a classic mistake that a lot of us make, even some of the best investors.

So we'll discuss it a little bit more later. But the interest rate environment has dramatically shifted over the last three years. As a result, the opportunities have changed. So there are many reasons why you should consider investing in bonds, but let me give you three that I believe are specific to today's economic backdrop.

First, income. Interest rates have mostly climbed since 2022. So as I've heard one of our analysts at Fidelity say recently, "The 'income' is back in 'fixed income.'" If you're looking for a way to generate reliable income and potentially benefit from these high rates that we have today, bonds can do that for you.

I would say second would be the potential for price appreciation. So keep in mind that if interest rates continue to drop, the value of bonds will generally go up. So the Fed cut rates three times last year. If the Fed continues to cut rates, bonds can increase in value above and beyond just the interest that they're paying.

And then third, and finally, I would say protection. Here we are. Stocks are near record highs. This is a good time to do a disciplined check. Make sure you've got proper balance in your portfolio. Bonds sometimes, it can be a shock absorber for stocks when they become volatile.

And keep in mind that if you hold the bond to maturity, you get back everything you put into it plus the interest that it's generated. So even if you bought a bond before 2022 and you saw the value of that bond go down because interest rates went up, over time, as you hold that bond, it starts to get back up to the value that you paid for it.

SUZIE: Well, Matt mentioned the shifting interest rate environment, and that's a question a lot of investors are asking, especially with uncertainties around fiscal policies and tariffs. So, Christine, what are your thoughts about the direction of interest rates?

CHRISTINE: Sure. Yeah. Suzie, really in the best of times, I'd say it's difficult to accurately predict where rates are going. And then it gets even more challenging when you do have a higher degree of uncertainty, like we do today around different policies, right? That could impact markets so when you think about it from the fiscal perspective, you think about the implementation of tariffs, immigration, you name it.

But I do think when we talk about the direction of rates, we do have to start with the Fed. And I think all of that uncertainty is helping the Fed to stay on pause. So just a few weeks ago, right, in January, the Fed did not hike rates. And they really committed to continuing to be data dependent for the remainder of the year. And I think that's appropriate, right? Just given that backdrop we're talking about and how the Fed thinks about its dual mandate, in terms of keeping inflation in check and pursuing full employment.

Now, inflation has trended down from those peaks we saw back in 2022, even if it has shown to be still a bit sticky, just given some of the recent prints we've been taking a look at. Now on top of that, we have seen some cooling in the labor market over the last year or so. But even still, unemployment's still, I would say, relatively low compared to history.

And so with all of that, I do think some caution is warranted. Again, the debate over how the new administration's policies are going to impact both of those factors is alive and well. I do think it's difficult to assess how that's going to move markets or impact the outlook for rates until we get more clarity on what's actually going to be implemented.

Now, current market conditions suggest we may be in this environment of "higher for longer," for a while now. The market is currently only pricing in one cut from the Fed for the remainder of 2025. Again, I think it's hard to predict that, given the number of factors at play. But that seems like a reasonable assumption given, if we assume macro conditions stay where they are today.

I do think, Suzie, the other dynamic that's just worth mentioning is for much of 2022 and 2023, we had this inverted yield curve, which just means shorter-term Treasurys were out-yielding longer-term Treasurys. So take the difference between the two-year and the 10-year Treasury. Now, that relationship where the two-year was yielding more than the 10-year flipped last year. And today, the 10-year Treasury yields more than the two-year.

I think that difference between those two maturities, right, could continue to change, again, depending in part how the market perceives the impact of some of these new policies. But across all of this, if there's any upside, I do think it is an attractive period for fixed income, again, when you think about just how elevated yields are relative to where we've been over the last 20 years. So I definitely agree with Matt's sentiment that "the 'income' is back in 'fixed income'" these days.

SUZIE: Well, that's very helpful, Christine. So what does that interest rate outlook mean for bond investors, Richard?

RICHARD: Well, thank you. Well, I think at the risk of generalizing, I think many of our bond investors who had stepped back a little from bonds at the end of last year, and certainly in Q4—we saw the dramatic Fed cut in September, and they saw rates falling—as bonds were maturing in their portfolios and as they were looking at allocating the next investment, I think they stepped back a bit at that time, thinking rates were going lower and that therefore, interest dwindled—buying interest, that is.

I think now, as with regard to the rate environment and the perspective that Christine just gave, I think people are taking a second look. For many years, for the last few years, we've seen that inverted yield curve that Christine spoke about has attracted people at the shorter end of the yield curve. And those rates are still fairly decent. I think people are now looking at a more stable rate environment. They're seeing those rates in the short-term Treasurys or CDs from around 4.2% to 4.3% and thinking, well, that's actually pretty good, compared to say, a bank, a savings rate, and high-yield savings rate, even there, and taking another look at investing in bonds.

And I think finally, I would say that this environment has to be looked at in perspective, as Matt was mentioning, in perspective with the stock market. Has been strong, it is tough to compete with those 20% returns. But at the same time, this is maybe an area to consider those valuations, that they're fairly high currently, and maybe taking a look at the allocation towards some fixed income, making sure that's fairly in place as well, given its safety.

SUZIE: Well, let's go a little deeper on the outlook question, since there are many different types of bonds. So can you explain how interest rate changes affect different types of bonds?

RICHARD: Yeah, sure. I think the answer is a little complicated because there's more than one type of bond, and there's more than one type of interest rate. So let's take the interest rate first with different maturities. Let's begin that with the yield curve. Now, the yield curve is basically a way of plotting the maturities of different bonds of the same type throughout time. As they mature over time, you can plot the different yields, and you create this line. And the line is known as the yield curve.

And what we're showing here is in green, several years leading up just before COVID. And then as COVID hit, we really hit very low rates. And then we began to come out of COVID, and we hit to the top part of the chart, the blue line. And then all these curves are periods of time of the Treasury yield curve.

And one of the takeaways I think may help people to think about is the way that the short maturities—so short types of short-maturing bonds—are very impacted by the Federal Reserve and their actions. So you can see here, the light green was just before COVID. The bright green, that is. And then when the Fed cut rates aggressively, look how that short yields move way down in reaction to the Fed's move.

But the longer part of the curve, out years, 10 years, 20 years of maturity, didn't move as much. And ditto. When the Fed moved rates aggressively in 2022, look how much the yield curves in blue and gray. They made that big step up in the shorter part of the yield curve. Whereas the longer part, yes, they did move, but they didn't move quite as dramatically as the short part of the yield curve.

And really, what we're saying here is if you're looking at longer-term maturities, those yields are more impacted by the health of the economy, the market's expectations on interest rates, and inflation, and general, again, economic growth factors. So it's all indeterminate versus just looking at where the Fed are going, which is more impactful on the short term.

Now, turning to the other part of the question, the types of bonds, we've just there mentioned Treasurys. It's worth mentioning that there's not just that Treasury market, and there's other bonds—for example, corporate bonds, municipal bonds, and so forth. And in a buoyant economy, those bonds will be more impacted by those factors than say, Treasurys.

So here, for example, we show the performance of a number of different bond categories and their performance in certain years. And I think most dramatically, you see what I'm trying to say here in 2008, 2009. And at the far left, we see high-yield corporate bonds, so junk bonds, and investment-grade corporate bonds to the right of those.

And notice how in 2008, the downdraft that those returns delivered. So those types of bonds, particularly high-yield, so aggressive, high-yield or junk bonds almost act like equities. They really lost money in 2008. Go to the far right and you can see Treasurys. In 2008, US Treasurys performed well. They delivered positive returns.

But then in 2009, as the economy began to recover and, of course, the markets always lead the way. It didn't feel that buoyant in 2009. But certainly, the markets began to sense that the worst was behind us. Notice how the aggressive high-yield bonds really turned, did very well. Investment-grade bonds delivered a decent positive return. But then the Treasurys actually lost some money in that year. So it's very important to think about, as people look at the bond, landscape. There's plenty of choices, both in terms of maturities and in bond types, and they do react differently in relation to different factors.

SUZIE: Thank you. Now given all of this, Matt, are you suggesting any different strategies for bond investors, given the current outlook?

MATTHEW: So the short answer to that is no, but there are some options that investors could substitute for bonds. So let me explain. We do believe that bonds play an important role in a portfolio. As mentioned, all those benefits that they offer—hedging, stock risk, providing income, they're fairly liquid. You can sell out of them when you need money.

But with that said, I understand if you have some hesitation about investing in bonds because while we do consider them to be a conservative investment, a relatively conservative investment, they're not a guaranteed investment. In other words, bonds do have some level of risk. For example, if you buy a bond and then the interest rate environment behind the scenes shifts against you and then you need that money out of the bond, you could sell the bond and potentially lose money if you sell it when interest rates have gone up.

And then there's also the risk of the issuer. So the entity that's backing the bond, if they go out of business, then your principal is at risk. So there are some risks. So there are other investments to get to the yes part of my answer, which is yes, there are other investments we can look at that do offer protection, and don't have quite the ebbing and flowing nature of a bond portfolio.

So for example, CDs, Treasurys, fixed annuities, those tend to be pretty secure investments that you can invest in. And oftentimes, I hear people are surprised that we actually have those types of investments at Fidelity. But it's important to remember that we're not just a stock and bond firm. Fidelity does have a tremendous offering—it's very broad—of both products and services. So if you're interested in alternative investments or precious metals, for example, we offer it all. If you're in any way worried about bonds, just give us a call.

SUZIE: All right. So one thing on our clients' minds is inflation. And what's the likelihood that inflation will return as an issue, and what does that mean for bond investors? Richard?

RICHARD: Yeah. I'll take that one. Yes, certainly. Well, opinions vary on this one. It's a hot topic, as you say, Suzie. I think we can say that inflation has been an issue for investors ever since the summer of 2021, when inflation first went above 5%, on its way to 9% just a year later. Now, the CPI has fallen. We saw some numbers yesterday. It's still fairly high, though, at 3%. And core CPI, which is less food and energy, that's been stuck at over 3%.

So I think another reason why it's an issue for people is because they experiencing the high cost of borrowing, like say, credit card rates over 20%, and 30-year fixed rate mortgages currently over 6.5% and on their maybe, way to 7%. So they attribute these levels all to inflation, and that's to say nothing of grocery bills.

So I think if inflation were to accelerate higher from here, bond yields, including the government bond yields or Treasury yields, could certainly react and move higher. And why is that? Well, fundamentally, it's because the higher inflation goes, the less real return, which is the return after inflation, there would be for bond investors. And so what happens in reaction to that is that bond prices fall and their yields rise to compensate.

Now, for much of the 2000s, developed nations were able to benefit from the various structural factors that helped dampen inflation—the rise of global trade, allowing a global workforce to come into the equation and reduce the cost of many manufacturing goods. But since the global pandemic, there's been a shift in these trends, and it looks like some of them have long-term structural implications for productivity to be weaker, and demands on governments to step in and assist. And all of that can increase the inflationary pressure. If not in a straight line, over a 10-to-20-year period, this could drag bond yields higher.

Now, it's likely to be a slow process, just like the 40 years it took for Treasury yields to fall from 15% in '81 to their low of half a percent in '21. I think if you look at the chart here, you see this is a chart of 10-year Treasury yields. And so as I said earlier, reacting more to the—oh, sorry. Go back one, if you would. Thank you—reacting more to the state of the economy.

But many of our viewers may remember the high inflation and the high interest rates that existed in the '70s and '80s, but you can see how those peaks were arrived at, through a multi-decade trending process starting from the '60s. And as I say, the trend down to the low of 2021, that took almost 40 years. So there's a ups and downs along the way, if you like, if you even accept this long-term trend idea.

MATTHEW: Hey, Richard, maybe I'll just want to add one point because you talked a little bit about real yields, and I think that's an important concept. So you know, again, real yields are the yields investors earn after accounting for inflation. And so if you take the 10-year Treasury today, the real yield on that is 2%. And really, you'd have to go all the way back to 2009 to earn that level of real yield. So again, I think from a historical perspective, if you're looking at it from that angle, again, that feels pretty attractive.

RICHARD: Yeah.

SUZIE: All right. Well, let's talk some more about the role of bonds in a portfolio. So Matt, how do you determine the right mix between stocks and bonds with the client?

MATTHEW: Yeah. I'd say very carefully. There are a lot of factors to consider, and it really just depends on the investor's situation. So when determining your stock and bond ratio, we don't follow a simple plug and play type of formula, or a one size fits all. I get the question a lot from Fidelity investors asking if we believe in the 120 Rule.

And for those of you that might not be familiar with this rule, it's a guideline that says if you take 120, subtract your age, that should be the allocation that you should have in stocks, and then the rest should be in bonds. And by the way, it used to be the Rule of 100, but because people are living longer, they changed it to 120.

Unfortunately, it's not quite that simple. The answer on how much you should have in bonds is primarily based on factors such as what's your goal for the money? What's your time frame before you start to need to withdraw from it? How much are you going to start to withdraw? What will that withdrawal strategy eventually look like? What's your risk tolerance? What does the market look like? What is the interest rate environment look like? There's so many factors to consider.

I recently worked with a couple in their early 60's who had just retired, and they had been advised by another firm to go ultra conservative with their portfolio and invest most of their money in bonds. And they came to me, to Fidelity, and I represented Fidelity at the time for a second opinion. And through planning, through getting to the bottom of these questions that I just asked and really understanding what their need for the money was and all of those things, we actually came back with a proposal that was much more growth oriented, that had more stocks in it.

And one of the differences, among many, was that although they needed income from their portfolio at the time relative, to the size of their portfolio, they really didn't need that much income. So how old you are certainly plays into the answer, but it's not the sole determinant. My suggestion would be to give us a call. We'll go through your unique financial situation so that we can come to a sensible asset allocation for your goals.

SUZIE: Those are really important factors to consider. We talked about different types of bonds. So let's revisit that a bit. And Richard, I'm wondering what role can muni bonds play in a portfolio?

RICHARD: Yes. Well fundamentally, municipal bonds may offer federally tax-exempt income, although there are also municipal bonds that are taxable. And also, if you're buying municipal bonds inside your state, there's potential for state tax benefits as well. And so if you have a high level of taxable income, that can be of benefit to help avoid any tax impact.

And in addition, history has shown that munis in general have had a low default rate compared to say, for example, corporate bonds. Now, right now, I think we're living in a period where many municipal bond issuers, from states, to cities, and smaller towns collectively, have been in pretty good financial health and have seen credit ratings boosted in recent years. And historically, too, municipal bonds have shown resilience during recession, even though there may be periods of volatility and some price declines.

We're showing here on this chart, it's a little bit to take on board. But the light green line is the yield of the US Treasury 10-year bond. And you can see, its axis is on the left. And the darker green line shows the percentage yield of the municipal benchmark expressed as a percentage of that Treasury. And the scale there is to the right.

And you can see how over time, the percentage yield of the dark green line has been very stable. There's a stable relationship between the yields on Treasurys and the yields on munis, meaning that municipal yields will be lower because they are accounting for the fact that many of the investors will gain from the tax impact, the tax benefit.

But you can see there's been a few spikes, and there was a big spike in COVID for municipal bonds. They sold off dramatically. But that soon reverted back. And you can see here, we've had, again, a fairly stable relationship with municipal bonds. And again, it's around 68% to 70% is the current level of the yield on the taxable Treasury bond.

So there's various ways to look at municipal. I'd say fundamentally, they're in a very safe place to be. Obviously, do your homework. And they are rated. So the ratings agencies are keeping a close eye, if you like. That's one way for investors to keep a guideline as to how risky do they want to be. For example, at Fidelity, we only offer investment-grade municipal bonds as individual securities, and don't go further into lower credit quality, although they do exist.

SUZIE: Now, how should an investor approach the decision of whether to invest in short--term, intermediate, or long-maturity bonds?

MATTHEW: That's a great question, Suzie, and it's one that I get often. And there are several factors to consider. Let me give you four. I think the most obvious is the time frame on the money.

So if it's a short-term bond and you have a short time horizon for that money, that's probably most appropriate. Number two would be your risk tolerance. So shorter-term bonds are less volatile than longer-term bonds.

Number three, diversification. We'll preach diversification all day long with your assets, and diversifying your bond portfolio across different maturities can help with managing risk and potentially even enhancing your returns. And then fourth would be the interest rate environment. So when interest rates rise, short-term bonds become more attractive usually, because they're less impacted by rising rates.

And the inverse, when rates are expected to fall, longer-term bonds may be more appealing as their prices tend to rise when rates decline. In more of a stable interest rate environment, you might consider intermediate-term bonds because they tend to offer a nice balance of risk and return.

SUZIE: All right. Let's talk a little bit about credit quality. So Christine, can you explain the relationship between yield and risk?

CHRISTINE: Sure. Yeah. And Suzie, I think that's a really important concept for any fixed income investor to understand. So, we've talked a little bit about this, but just again, when you buy a bond, you may decide to hold it until maturity, and in that case, where you expect you're going to get paid the principal amount when the bond matures.

So really, when we talk about the creditworthiness of an issuer, that's what matters, right? You want to gauge their ability to pay that final amount at maturity, and that they're going to be able to make interest payments along the way. So you take something like a US Treasury, and we generally consider that to be the risk-free rate because we expect the Treasury is going to make all of their payments to any holders of those securities.

But when you start to look at bonds that are issued by other entities, so say a corporation, right? That's where you may be able to earn a higher yield relative to a Treasury since there's more what we call, credit risk. And that difference in yields is what we call the credit spread. And generally, investors are going to demand a higher yield for issuers that have weaker fundamentals. So you're typically going to be able to get a higher yield for a security that's rated BBB by the credit rating agencies versus those that are rated A or AA with a similar level of duration.

Now, I will say in our seat as active managers, we often find a lot of value in those lower-rated securities, and we tend to lean into those credits because we think our research team can help us uncover securities that are generally undervalued by the market and where we are comfortable with the fundamentals, based on all of the proprietary analysis we've done.

Now, I'll just say broadly, credit spreads are pretty tight or narrow these days versus Treasurys relative, again, to where we've been over the last two decades. And I think that's probably warranted, just given that strong economic backdrop we've been talking about. But I do think they're susceptible to moving wider if we get any type of growth scare. But again, I think this is a common theme we've been talking about. I do think this is, again, why it's so important investors do their own research and really understand the bonds they're buying in their own portfolio.

SUZIE: Now, let's consider an investor with a short time horizon. Should they keep their cash in CDs or high-yield savings?

MATTHEW: So I think it depends on what's meant by a short time horizon. If it's a short time horizon for all of the money, then the answer might be yes. As much as we don't want to admit it, sometimes we don't know where the market's going in the short term, in the next year. In the short term, the market can be fickle and unpredictable, and you could have a really healthy and good economy and a down year in the stock market. That happens sometimes, like in 2022, for example. And the same applies for interest rates. Hard to know exactly where they're going and when.

So if you have a need that's coming up within the next year or two years, and it's a large purchase, let's say, a car purchase, tuition, wedding, something like that, then yes, you might think about leaving that in something short term that's protected, like cash.

I mean, if you think about it, a $50,000 car—let's say you know you're going to spend $50,000 on a car later this year, and the market's here close to an all-time high. Let's say the market moves against you and you didn't take it out of the market. Well, now you're selling more shares to get that same $50,000 out. So it certainly makes sense to have that protection mindset in the short term.

But I want to make a distinction here because there is a difference with investors that are retiring. I hear a lot of times—let's say you're 65 and you're about to retire. I'll hear investors say, I have a short time horizon. And while I understand the sentiment there, the reality is you're probably not going to spend all of your money in the first couple of years of retirement. So otherwise, you're going to probably have to go back to work, and we'll have to do even more financial planning.

But in other words, you'll still need to keep that long-term perspective on your investments. You'll still need to have stocks in your portfolio to hedge inflation and high medical costs that you're sure to have in retirement. So you'll still need a healthy amount of bonds as well to be a ballast in your portfolio as stocks go down sometimes. So while cash has the potential to protect, it may not perform as well as stocks and bonds over the long term.

RICHARD: Yeah. And I think if I could just add, I think Matt's right when he speaks about the value of cash in terms of those spending needs, giving you that predictability as well as allowing the padding for the extra unexpected. But I think, as I said earlier, the positive thing about the current environment is that investors have the opportunity to earn both a decent return on their savings, money market type of investments, as well as the [INAUDIBLE] that [AUDIO OUT] short-term part of [AUDIO OUT] whether it is a two-to-five-year CD, or a Treasury can also allow investors to lock in those pretty good rates around, again, 4 and 1/4 to 4.5% [AUDIO OUT] money, and just thinking of that as the step beyond cash that might not be quite so foreseeable.

Again, as we've been saying, the future is unpredictable, but it's a pretty decent return. And just remember that if you do hold to maturity with those instruments that they're not equivalent to cash, it's best to think of them sitting there to mature when they do, and not equivalent to cash. So having a bit of both there might be a good strategy too.

SUZIE: All right. Well, I want to ask a related question about cash. We know many investors are keeping a significant amount of assets in cash, but how much is too much? How do you help clients determine the right amount of cash to hold?

MATTHEW: Yeah. So just like with bonds, we believe cash plays a very specific role in a portfolio. For example, we believe you should have an emergency fund. So this would be money in cash to cover essential and unexpected expenses for three to six months. Number two, cash can help you be more tactical with your investment strategy. The market moves, and you've got cash. That's kind of dry powder. You can take advantage of an opportunity quickly. And then number three, like we had mentioned, to cover large expenses that are known, that are coming up.

But what's interesting is we're seeing a lot of investors that are overweight cash right now. And the question is, how much cash is appropriate, and are you paying a price by maintaining too much cash? Historically, the rate of return on cash has lagged the rate of inflation by 0.83%, meaning holding cash for too long might actually be causing you to lose purchasing power on your money, even in high interest rate environments.

So it's kind of interesting. A couple of years ago, when rates were near zero, I felt like investors that I was talking to were kind of scrambling. How do I get more return on my capital? How do I lock in higher rates? And now that rates have gone up, I'm seeing some of these investors, the same ones are reluctant to lock in those higher rates, and I can see why. We had this inverted yield curve where you could get just as much on cash as you could on bonds. And only until recently has that yield curve normalized where you can now get more interest the farther out you go on the yield curve.

It's also important to know that as the Fed cuts rates, you tend to get less interest on your savings accounts and money markets. That's where it really makes the impact is on those shorter-term investments as opposed to bonds, where like we had mentioned, as the Fed cuts rates, you have the potential of price appreciation with bonds.

So if you're cash heavy in your portfolio and you want to talk about it, please call us. We can put together a plan. It might involve baby stepping out of cash. And in that way, that could really improve your yield and give you the benefit of getting potential price appreciation as rates do come down.

SUZIE: So Christine, earlier you talked a bit about your team, and would love to understand how you are positioning portfolios that your team manages.

CHRISTINE: Yeah, absolutely, Suzie. So within our fixed income managed accounts, we don't take big duration bets right now. No big bets on which way interest rates are going to move, just given everything I talked about earlier about how hard it is to predict that direction. So from a duration perspective, we're more neutral. We do expect the yield curve is going to continue to steepen. And again, that just means that difference between longer-term rates and shorter-term rates is going to continue to increase. So we've been positioned for that.

Now, within our tactical strategy, just given today's environment, we do think yields and fixed income are attractive. And we're being cautious on investment-grade corporates. And I'd say that caution is really based on valuations rather than fundamentals, right? Again, a fundamental backdrop feels very strong. So from our perspective, it's still important to have an allocation to investment-grade corporates. They're a really important source of yield in our client's clients' portfolios. And again, we're leaning into our broad research organization to help us find attractive names to own, but we're just being patient with how much exposure we have there.

One area we have liked is securitized. Now, securitized just means basically bundling underlying assets into securities that can be sold to investors. So think of this as mortgage-backed securities. Within that space, we've seen some more attractive valuations relative to other sectors. Now, within our muni accounts, same thing, right? We're staying allocated across a number of different sectors, including those that are more revenue backed.

But one area we have been adding to, our local general obligation bonds, which tends to be the most liquid parts of the muni bond market. If I had to sum up broadly, Suzie, sort of the themes across all of our portfolios, I'd say it's continuing to emphasize diversification, and just being really patient as we wait for a better opportunity to add risk into portfolios.

Even as professional managers, I'd say it's really difficult to time the market. So typically in an environment like this, we just try to maintain a lot of flexibility so we can adapt to any unexpected sources of volatility.

SUZIE: So we also receive a lot of questions about the many options for investing in bonds. So Richard, for clients who do want to invest on their own, can you give us an overview of the options?

RICHARD: Yes, Suzie. Sure. Thank you. Well, we have lots of options here at Fidelity. We offer access to every type of bond, really, from municipal bonds, corporate bonds, Treasury bonds, et cetera, we've spoken about. We offer access on the website. That's Fidelity.com /fixedincome. You can participate in the auctions and the new issue market as well as the secondary market. So we really try to bring transparency into those markets to allow people to invest, just like they would with stocks.

But strategically speaking, I'd like to talk about a popular way that investors have found value over time and a way of structuring the portfolio, if you like, through a bond ladder. A bond ladder is, again, it's not just proprietary to Fidelity. It's commonly used as a way of managing some of the potential risks from changing interest rates.

So what it does is it almost forces one to—rather than thinking about buying one or two bonds at random, or a handful of bonds randomly that mature on random dates, or maybe a particular persuasion that you're focusing on, for whatever reason, a bond ladder almost forces one to have a spectrum of maturities across the yield curve that we showed earlier. And really, this is a way of trying to hedge interest rate risk. So for example, if market rates were to fall in the future, your ladder will help ensure that at least some of your bond portfolio is maintained at those higher rates that you had purchased when you had originally bought the ladder.

Similarly, a ladder may be useful when yields and interest rates rise, right? Because even though you purchased at the given yield at the time, it means that at very regular intervals, some part of your portfolio is maturing. So then, those maturing principal money can be used to reinvest at the higher rates that exist in the future. And I think overall, ladders help investors in a way, enforce a type of self-imposed discipline.

So instead of thinking about, do I buy? Do I sell? A ladder operates almost on its own accord. You really let it dictate when the bonds or CDs are maturing. And at that maturity date, that's when you have the decision to make. Do you reinvest in the ladder when you would typically reinvest at the longer end of the ladder to extend it, or do you use the money for other things, other investment opportunities, even?

SUZIE: Well, Christine, similar question to you, but for clients who might want professional help with bond investing. What options exist?

CHRISTINE: Yeah. Well, I think, Suzie, it's not surprising that there are a number of people out there that want that professional management. Fixed income can be complicated. There's a lot to navigate. So I think certainly for investors that don't want a do-it-yourself or DIY approach, it makes sense to look at things like fixed income mutual funds, ETFs, or even managed accounts.

I think certainly, one popular way is exactly those bond mutual funds and ETFs. Those are typically very highly diversified vehicles that offer daily liquidity for clients. So I categorize that as both as being a really efficient way to get access to the bond market and particularly, may be useful if you're looking to invest just a smaller amount.

The other part of that is if you are buying an actively managed mutual fund or ETF, that the managers of those vehicles often have a bigger pond to fish in when they're trying to find different opportunities to generate returns. So that really just means they're able to invest in sectors outside of the index as well as trying to decide which sectors do they want to over or underweight, or do the same type of analysis for specific issuers.

And really, the professional managers that oversee these products, they're tapping into all the insights they get, not only from the research analysts that support them, but certainly, the professional traders that work on these strategies as well. All of what I just talked about, Suzie, is really in contrast to an index or passive strategy. And in those types of index funds or ETFs, there, the manager's really just trying to mirror the returns of the benchmark for that strategy.

Now, the other option, if the mutual fund or the ETF doesn't feel right, is that you can invest in something called a separately managed account, or SMA. And so in that category, you still get the professional manager who is going to manage your money, but they're just going to go out and basically pick individual bonds for your account. And under that construct, you may have some ability to customize your portfolio. You're also going to get to see all the positions and the trades in your account, and you ultimately own all of those holdings.

Now, on the flip side, I do think it's important to understand if you want to redeem a portion or all of your account, it could take a little longer than your ability to get liquidity through a fund or an ETF. But I think if you ultimately want professional management, and some ability to customize, and transparency into your holdings is really important, an SMA might be a good option to consider.

SUZIE: Thank you. And Matt, help us tie it all together. How can a financial professional help with these decisions?

MATTHEW: I believe in many different ways, Suzie. I think even my job has changed over the last 13 years that I've been doing this. And of course, we're always going to focus first on your goals, and then work with you to allocate your portfolio accordingly, talking through your stock and bond allocation. But stop and think about the complexity of wealth today, all of the ways that you can invest your money, and how you can look at opportunities to make it work harder for you and more efficiently for you, and how the typical investor has so many financial decisions to make beyond asset allocation, and how it can be really confusing.

I believe at the end of the day, that if you partner with a competent advisor, that your likelihood for success improves quite a bit. So having more money doesn't necessarily make life easier.

It's funny, I was talking with one of my clients who's approaching 80 not long ago, and we were reviewing her account that had increased in value quite a bit. And I said, you know what they say, more money, more problems. And she quickly said back to me, Matt, I like those kinds of problems.

And I get it. I mean, it's fun having more money. It's fun seeing your balances go up. But it does come with more responsibility. How do I grow it? How do I protect it? How do I distribute it? How do I make it more tax-efficient? And it's not just about having more money. Yes, we want to help you grow your wealth. But I also want to help clients navigate through the complexity of wealth in order to achieve the confidence to enjoy their financial success, to do the things that are important to them with the people that they care about. And in other words, we want to have a personal impact on you.

So I see it all the time, especially nearing and during retirement. Your money starts to take on almost a new identity and mean something different, and it becomes personal. It could mean your lifestyle now. It could mean not having to go back to work, and so you want to become more conservative. Or it might mean a legacy to pass on to your kids or your heirs. And so you might want to be more growth oriented. Whatever it means to you, we want to create a plan and then stay disciplined to that plan, and occasionally alter that plan as the facts change.

SUZIE: Well, thank you, Matt, and I enjoyed the anecdote of your client there. Very wise. So, panelists, you've given our viewers so much to think about. And before we sign off, I'd love for you to share a few key takeaways, please. So, Christine, let's start with you.

CHRISTINE: Sure. Yeah. I was going to say, I'm going to end this on a positive note because I do think bonds offer a lot of value here potentially. And I come back to, why do clients want to own fixed income? And it's again, for that income. It's for capital preservation and the diversification benefits. And so, I think on that first part, when you consider how high yields are relative to again, where we've been as of late, you can get a lot from the income generation component.

I also like bonds from a capital preservation perspective, just given—we've seen and talked about really strong fundamentals. But also, just in general, these higher yields can help offset some price volatility. And then the last part is just the fact that bonds can offer stability, particularly versus stocks, I think. And that's particularly true when we're in periods of volatility that are not caused by the Fed. And so I think that important role of bonds being a diversifier is really important, and again, I think just adds to why I remain constructive on fixed income.

SUZIE: Awesome. All right. Richard, give us the quick hits.

RICHARD: All right. Well, thank you. I think Christine made some great points there, so I'll try and distill it down to my three, which is number one, we've talked about how hard it is to predict the path of interest rates. Rates could rise or fall from here. But the good news is, as we've shown hopefully today, that the rate environment is a lot healthier for any bond investor with bonds yielding above 4% versus just for much of the last decade or so, just around 1%.

So if rates rise from here, investors would potentially see some coupon income to compensate for any price loss, and also at the same time, have the opportunity to reinvest maturing bonds, as well as the coupon interest at lower prices, which then could potentially lead to even higher yields in the future. So I think this is a fairly good time, given again, the higher yield environment.

Second point is, as we've covered, there's more than one bond market. Just remember that high-yield or junk corporate bonds can behave more like equities than the higher quality Treasurys. And I think that gives, in a way, customers a lot of choice. And it's important to look at that credit risk. Christine spoke earlier about the credit risk, and think about that as you jump in. And remember again, that there's multiple parts along the yield curve as well to consider.

And then I think in the summary, I would say one of the factors we like to remind our clients about is the danger of reaching for yield. And what we mean here is again, consider credit risk. Consider the rating of a bond and keep a close eye on it. It isn't fixed. It can change over time. And remember that the riskier the bond is, the advertised yield may be high and alluring, but if the bond is riskier, then there's a higher chance that you won't receive all that return of the coupons and the principal at the end of the life.

So that's where you come back to Treasurys with the government guarantee as the starting point, if you like, and looking at risk beyond that for other types of bonds.

SUZIE: All right. And Matt, let's wrap with you.

MATTHEW: Yes. Thanks for having me. My key take away from this is simple. It's important to future investment opportunities and not let the past skew your judgment. I talk to people all the time that are so focused on past performance. And to me, focusing on past performance is like driving your car with the rear view mirror. Yesterday's bond market is not today's bond market. The market backdrop and interest rates have changed, and there is great opportunity out there.

So come meet with me and my team, please. We can build out a plan that can help take advantage of some of these opportunities that exist in the fixed income space.

SUZIE: Well, thank you all. Now, if you have more questions about bond investing or how bonds fit into your portfolio, please reach out to your Fidelity representative. And if you don't have a representative, visit Fidelity.com/FindAnAdvisor. And for more timely news and updates and insights on other financial planning topics, subscribe to *Insights from Fidelity Wealth Management*℠ for exclusive invitations to future wealth management webinars and access to our weekly newsletter. Thanks again for joining us.

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