Bond Investing Beyond Yield

Webinar Transcript

JONATHAN LAMOTHE: Good afternoon, everyone, and thank you for joining our webinar today, "Bond Investing-- Beyond Yield, a Deeper Dive." My name isJONATHAN LAMOTHE, vice president of educational events at Fidelity, and I'm going to be your moderator today. Our conversation in this webinar is withDANIELLE FOX. Danielle is a fixed-income brokerage consultant, whose role is to educate and help guide self-directed fixed-income investors.

Danielle is going to be in a deep dive into the bond landscape to discuss key market trends, bond research, and investing strategies. So I'd like to welcome Danielle. Danielle, how are you doing?

DANIELLE FOX: Good afternoon. Good to see you, Jonathan. And thanks to everyone for joining today.

JONATHAN LAMOTHE: Before we begin, I do want to run through some housekeeping items. We do have a Q&A tool to the right of your video. If you're joining us on a laptop or a desktop, you can submit questions.

And we're going to do our very best to answer as many as we can. We do focus on the top-voted questions, so just keep that in mind. We may not be able to get to everyone's question. You may also use this tool to add any comments you'd like us to know about your experience today.

Also on the bottom of your screen, there are buttons to download today's presentation. In the QA announcement tool. There's also a link to a Vimeo page if you are having any technical difficulties viewing this webinar through the current way you're doing it. After the presentation, Danielle and I will be answering some live audience questions, so please stay tuned for that.

Before we go, there are a few upcoming webinars you all may be interested in. Tomorrow, we have "The Fed Bonds and Your Portfolio." This is actually going to feature Danielle again tomorrow, as well as former Fed Chair Ben Bernanke. As we discussed, the current Fed moves, interest rates and what it all means for you.

Also on October 3, we have "Learning More About Brokered CDs." In this webinar, you can learn how CDs can help manage your cash positions and help you immediately and in the months and years to come. You can register for these and more upcoming events at fidelity.com/webinar.

So with all that out of the way, I'm going to turn it over to Danielle, and I'm going to pop back in at the end for Q&A. See you all in a bit.

DANIELLE FOX: Great Thanks, Jonathan. And thank you so much to everyone for joining. As Jonathan mentioned, my name isDANIELLE FOX, and I'm a fixed-income regional brokerage consultant here in the Boston area. And I on a day-to-day basis tend to spend time coaching clients based on how they like to invest in the fixed-income space, going over resources and discussing strategy.

We've hopefully got a pretty timely discussion today around a deeper dive into the bond market, and we'll go through some prepared comments and then hold some Q&A towards the end. As Jonathan mentioned, the slides are available for download, so don't be bashful about pulling those down if you think it's going to be helpful for today's conversation.

So as we dive into what we're going to be doing today, I always want to think about having a strategy and really focusing on maybe a few more of the sophisticated aspects of the fixed-income market today. There will be a little bit on website functionality that might support some of the strategies that you have in this space. But we're really talk through some insights around making informed decisions within the bond market.

When we think about some of the questions that might come up that are somewhat timely, it's risk and reward trade-offs for different types of bonds within the bond market, the interest rate cycle, which is obviously quite timely right now given the Federal Reserve last week, and how that might affect your investment strategy. And then really thinking about what role bonds play within your overall portfolio. So those are some things that are, I think, kind of sitting front of mind for a lot of investors right now. So let's take a peek at the agenda.

And we're really going to focus on four aspects today. First is an macroeconomic trends. So what's going on in the economy and the markets right now and how that might inform your view?

Second, we'll look at three aspects or dimensions of fixed-income investing that Fidelity and I concur-- believe are important to have a working understanding of. And then we'll dive a little bit deeper into maybe two of the more sophisticated pieces of the bond market, the corporate market and the municipal market, before rounding out with strategies. So kind of going clockwise on this agenda.

So without further ado, because we obviously want to save time for questions towards the end, let's take a peek at some of the key drivers in the economy and some of the most recent headlines that might affect how you think about investing in the bond market. I'm going to sit on this slide for a second. There are several bullet points here. Again, this could be a good slide to reference if you've downloaded it.

But obviously, some of the key drivers, we just had a rate cut last week. Perhaps some of you are surprised by it being a half a percent as opposed to a quarter. I would say the market had a little bit of uncertainty about whether or not it was going to be a quarter or 1/2%. Fed ended up going with a half.

But in that Fed announcement, they also provided what they call a summary of economic projections and updated what are called the dot plots. And they gave us the answers to the test for the rest of the year, which is they're expected to cut another 1/2% by the end of the year using those dot plots as guidance.

So there is a November and a December meeting, whether it's one half or .225, the marketplace is expecting another half a percent of rate cuts by December 31. That's one key takeaway that I would want to have as I think about either creating or maintaining a fixed income strategy.

After this year, though, the big questions are really kind of twofold, which is, how far are they going to cut rates, and where will the Fed funds rate end up? And then how quickly will that occur? So the magnitude of rate cuts, how much are they going to end up cutting rates by is the big question that is subject to, I guess, a lot of debate, both internally and externally.

That will be influenced by how is the labor market doing. It's softening, and unemployment rate is rising, though maybe not for the reasons that you might expect. Obviously, some companies are making changes to their labor force.

But in addition, you've had a lot of folks come back to the labor market that may have been sitting out. So someone that re-enters the labor force can actually affect the unemployment rate if they haven't found a job yet. So it's not just a demand piece, but also a supply piece.

And then another thing that's going to have an impact on rates will be quantitative tightening, which when you think about what the Federal Reserve has done since the financial crisis, they expanded their balance sheet by purchasing things like treasuries and other types of government securities. And at its peak in 2022, that number, that balance sheet number was almost $9 trillion. And the Federal Reserve has been slowly letting the world's largest bond ladder unwind a little bit. And it's now closer to $7 trillion.

So the Federal Reserve is not buying bonds to the extent that they were. So that demand isn't necessarily there. So those are some aspects of the market and the backdrop that you want to be cognizant of.

Inflation is trending in the right direction. The last mile of inflation might be the hardest piece, unwinding all of the aspects from COVID. But these are some kind of key aspects that you want to be cognizant of.

So again, kind of key takeaways, another 1/2% by the end of the year. And really, we're getting into the conversation around just how far are they going to cut rates? What is the end for them? And it may be something where the Fed funds rate ends up being closer to 3.5% or 3%.

As we think about trends, employment and inflation are the two key mandates that the Federal Reserve is trying to account for with policy. The challenge with recent data is the 2020 COVID pandemic really skewed numbers in a substantial way. But we're now getting back to a point where indicators like the unemployment rate, even inflation and jobless claims, which are aspects that influence the dual mandate of employment and inflation, all of those are getting awfully close to pre-COVID levels. So we're in striking distance.

So as we think about the economy, we're kind of back getting awfully close to late 2019, which was a late cycle at that point. And again, the skew from 2020 took a while to work its way back, but we're finally within striking distance on that. So what we'll see here is the unemployment rate, labor market, inflation as measured by core CPI, or Consumer Price Index.

And when you look at this chart and you see the light blue, it's using the two-year Treasury note from the legend below. And the reason that's meaningful is there's historically been a very strong positive correlation between the Fed funds rate and what it does and the two-year Treasury. So shorter-term interest rates are more highly influenced by the rate that the Fed cut last week.

As we expand it a bit here, the two year is listed in that kind of olive green color. And then in the navy blue, we now have the 10- year, which is the longer-term interest rate. And we're now overlaying this with points in time when the Federal Reserve is raising and lowering interest rates and also when onsets of recession have occurred.

So when we think about the Fed here, the Fed hikes rates to, in essence, cool the economy. And a recession often follows at the end of it.

The challenge this time around, though, is the bond market is currently expecting far more aggressive rate cuts than, say, what the equity market is thinking about, which is what? We've had like 41 all-time highs this year. It's always flirting with record highs. So the bond market and the equity market, do have some slightly different points of view.

And as we talked about the two-year note, that lime green or olive green color, is much more closely correlated to what the Federal Reserve is raising and lowering, which is that light blue. And you can see there's a relationship between the two.

But as we go further out and we look at, say, the 10-year Treasury, it's oftentimes more closely correlated in a positive way to the fundamentals of the economy, i.e. GDP or gross domestic growth. So when the Fed is raising and lowering rates-- and I understand that these are notable headlines right now-- the influence is largely on the shorter-term part of the market. And the further you go out, the less it is in theory about the Fed, and it's more about the fundamentals of our economy.

So that is the key takeaway that I would have, is that. And we'll talk about this with some of the dimensions. Like rates don't always move in the same way at the same time because there's different influencing factors.

So what happens when the Fed is raising and lowering interest rates? Well, this is going to show you on the left-hand side when the Fed is cutting rates and then when the Fed is raising rates. And we've just kind of pivoted between these two columns here. And how does this influence portfolio construction?

If we think about the interest rate cycle, a bit like a roller coaster. When the Fed has stopped raising rates and is getting closer to cutting rates or started cutting rates, you're at the top of the hill, the roller coaster, and you know where the next move is. And it's lower when you're late in the interest rate cycle like that. That's when the aim would potentially be to try and preserve yield.

And what do I mean by that? It's by perhaps picking up maturity within reason and kind of slowing down how quickly money comes back to you. In addition, you may say, all right, the concept of either duration or maturity could be used, depending on which one's more important to you. But when we think about where we are in the rate cycle and going into an easing cycle, in theory kind of want to start to slow down how quickly bonds mature on you so that you're not reinvesting as much in a potentially declining interest rate environment.

So that's a little bit about some of the macroeconomic trends or just kind of trends in general. And now I kind of want to pivot into the different dimensions. And as I mentioned, Fidelity, we're going to go over three today, three different dimensions of fixed-income investing.

The first is an understanding of the yield curve. We'll use the Treasury market as kind of a proxy for that. We'll talk a little bit about how different classes or segments of the market might perform differently and have different risk or return trade-offs. And then within any of those categories, sometimes there's a range of yields around benchmarks. So those are our three aspects or dimensions of fixed-income investing that we'll focus on today.

So with the next couple of slides-- and if you have the slides, you can kind of see we're looking at different aspects of time to talk through what yield curves might look like. There's really, in the simplest of terms, three types of yield curves that one could see. So I might end up toggling back and forth between these.

But the first is a steep or upward sloping yield curve. And I would say this is what investors tend to expect or want to see, which is as time goes on, I earn more. That's kind of conventional wisdom and what you would expect. If I'm going to forego receiving my principal back for a longer period of time, I want to get paid for it.

So this is typically something that occurs during a recession, or at the early part of an expansionary business cycle. So here we're looking at an example from 2010.

As I mentioned, in the summer of 2019, at the end of an economic cycle, you tend to have an inverted yield curve, which until recently is what we've had, and parts of the yield curve are still inverted. So depending on what your guardrails are for comparison, we may or may not have an inverted yield curve. But this is when the Fed's done hiking rates-- sound familiar-- at the end of an economic cycle. And this is the concept of short-term interest rates are higher than long-term interest rates. And part of the reason this would exist is those short-term interest rates, while they might be very compelling, will expose you potentially to reinvestment risk in a lower-- in a declining rate environment.

So this is something that can sometimes be a bit of a struggle. Why would I accept less for more time? Well, it's the idea that maybe postpone gratification, the idea that in a future state that lower yield today might actually be an above-market rate of return in the future. So it's also thinking through, again, that magnitude piece, how far do you think rates are going to fall? And then a flat yield curve is where everything yields the same.

And the Fed might still be raising rates. Growth is strong, but you're again kind of close to the end of an interest rate cycle.

So the market is going to move between a flat and inverted and an upward-sloping yield curve. And as much as we would like to get paid more for the element of time, it's not always going to be the case. So you're not always going to have an upward or steep yield curve. So dimension one, kind of understanding that yield curves aren't necessarily just a straight line up, but they can invert and be flat and all of those fun things. And historically, those have been indicators of where we are in the interest rate cycle and then also in the business cycle.

I will say the second dimension, which is not all bonds are created equal in terms of risk. This is one of my favorite slides in this presentation because one of the things that I will think about is, for example, asset allocation. You have a mixture of stocks and bonds and short term or cash. But if my bonds act like stocks, did I really achieve what I wanted to in terms of diversification? The answer is probably not.

So as you think about this dimension, that there are different risk-return characteristics, one thing I would think about as a general rule of thumb is the lower in credit quality you go, the more bonds start to act like stocks. So for example, on the left-hand side, HY corporate, high-yield corporates, those are junk bonds.

And so you start to see in 2008 and 2009, you're going from one end to the spectrum to the other. And that takes on a return characteristic that wasn't all that dissimilar to the equity market performance in '08-'09 with the financial crisis and trying to stage a comeback after that.

Emerging markets, the second set of returns from the left, is foreign junk. So again, the lower in credit quality you go, more often than not, the more they're going to start to act like stocks. So if in 2008 or 2007, I was seeking to diversify from the equity market and I chased yield, if you will, in the junk bond market, I might have changed what my asset allocation looked like between stocks and bonds, but my outcome might not have been all that much different.

So when you think about trying to mitigate the risk of equity market volatility, particularly if we're concerned about a recession and being in the late cycle, then quality is king. So you just kind of want to think through that. Not all bonds are created equal, and there is no free lunch. And think of this almost like sectors in the stock market that different segments of the market are going to take leadership opportunities at different points in time.

And as you start to go more towards the right with this chart, you tend to see higher quality securities, and the bandwidth of returns are going to be more muted. You manage potentially downside risk a little bit better in terms of negative returns.

So again, it's all about from a preference perspective and what your risk tolerance is trying to think through what types of exposures to these different aspects of the market do I want as it may inform what your asset allocation looks like in the bond space. But big takeaway, the lower in credit quality you go, the more bonds start to act like stocks at the end of the day. So that's kind of aspect two here.

And then even within a category, you're going to see potentially a wide range of yields within a segment of the market. So from fidelity.com, we have a landing page under news and research from the green banner at the top, halfway down, fixed-income bonds and CDs. And if you scroll about halfway down, this chart is going to show up, and each one of these yields is a search that would be very specific in nature.

And if I were to click on one, I could see that, for example, within the AA rated corporate space going out-- let's call it five years-- You are going to see a range of yields. So even in a specific category, I could see a quarter, a third, maybe even a half a percent of yield differential within a series of bonds that might look awfully similar in terms of credit quality and maturity. And this is the bond market trying to perhaps quantify default risk or different structures around call features and things of that nature, particularly callable bonds, as you might be heading into a declining rate environment where you're again trying to slow down how quickly money is coming back to you. And let's kind of pivot here.

So we talked about three dimensions. Like, what is the yield curve? And what is it trying to tell me? Like, what's the bond market trying to tell me when it's showing me a yield curve?

Not all bonds are created equal. And the lower in credit quality you go, the more bonds start to act like stocks. And then even within a category, you might see a wide dispersion in yield.

And again, it's the bond market trying to talk through or quantify that there is no free lunch. Let's look at some of the more nuanced or sophisticated aspects of the bond market in terms of corporate and municipal bonds. We're going to go a little bit deeper here today.

And so with that, this chart is interesting. And the first thing I want to call out is the squiggly lines on the screen might look the same. But when you look at the vertical axis, it's worth noting that the high-yield spreads on the right, which spreads are a fancy way of saying how much yield over a risk-free rate, meaning a Treasury, am I going to get? Notice that the vertical axis is by a factor of 3. So the chart on the right is actually three times bigger, as compared to the investment-grade space.

So when we think about that return profile that we were discussing earlier, the lowering credit quality go, the more bonds start to act like stocks. And to that end, there's more upside and downside. So there's a wider bandwidth of returns.

And what this is stating is that to a factor of say, three, there's a certain amount of extra yield that you're getting over US treasuries that is by a multiple of 3. The line kind of running through towards the bottom of each horizontally is looking at historical averages. And so as you start to think about the corporate market, we are getting less than historical averages in terms of yield compensation, both in the investment grade and the high-yield market.

So if I'm going to leave the shallow end of the pool, meaning a US Treasury, how much extra am I getting? And do I feel like it's compensatory? Do I think it's worth it. And if we're concerned about a recession, I might want to be above a historical average, given where we are in the business cycle, but everyone kind of thinks through that a little bit differently. It's just an opinion to offer, and it's helpful to know that right now we're kind of getting close to historical averages.

When I think about structure within the corporate bond market, a couple of things. One is structure is the issuer, the coupon, the maturity date, and whether there are any call features. All of those things can be important from a return perspective. I might care about coupon if I am-- because that's your cash flow, if I'm creating income to use as retirement, to pay for college, expenses, things of that nature.

But then another aspect, which is really important within the bond market, is thinking about risk and default risk. The average credit quality of the corporate bond market is not exceptionally high. It's a barely investment-grade asset class to start with. And so when we see a BBB-rated bond in this example, that's not unusual to see BBB rated, which is the lowest rung set of ratings in the investment grade space.

And so what's nice about the Fidelity platform is when I've clicked in to look at a bond in detail, underneath the Moody's and S&P rating, you'll almost always see issuer events with a Yes next to it. And both the municipal market and the corporate bond market have-- their regulators have identified activities or events that if they occur, are considered material in nature. And that information is kind of funneled through, and you're able to access it in real time. So for example, if a bond is at risk of being upgraded or downgraded or was upgraded or downgraded, all of those things are material events.

So if I'm looking at the CDF bond and let's say it kind of stuck out in a yield perspective in a high way, like it was trading at a higher yield than maybe some of its peers, I might want to look to see, hey, is this bond at risk of being downgraded? Is there anything going on from a ratings activity perspective?

I guess Ronald Reagan used to say trust but verify. It's a way to say, all right, the market's giving this a higher yield. What's behind that? And it could be the bond market trying to price in credit quality changes before they occur. And so any of those rating changes or possible rating changes if announced by Moody's, S&P, that would be considered a material event, and you have the ability to access that.

If we go a little bit deeper, when you think about when I'm looking for bonds on the website, whether it's corporate, municipals, treasuries, what have you, what we're doing is we're pulling together available markets based on the hundreds of firms that were trading with on a day-to-day basis. And we're kind of serving as like a centralized portal, if you will.

And so on the left-hand side, just like with equities, I sell at the bid. I buy at the ask. So I'm seeing what's called a two-sided market. If there's one available, I would say-- and we'll see this with the municipal market-- you don't always see an active bid since there's so many securities out there.

But in addition, we're using a third-party pricing service. So the analogy that I would potentially use is it's like looking up your house on Zillow.

You're not selling your house to Zillow, and you're not buying your house from Zillow. But they're trying to provide an estimated market value based on an algorithm that's at work. That's what the third-party price is, not something I can trade per se. But it's meant to be an indicative level.

When I think about that portal, and the aggregation of the different firms that we're trading with on a day-to-day basis, I can use something called depth of book, which allows me to see all of the firms anonymously and what they're willing to buy the bond from me at and sell them to me at-- so again, a two-sided market.

And then the last piece down below that, in the bottom half of the center of the page is once a trade has been done in the corporate bond market, whether it takes place at Fidelity or anywhere else, it is subject to-- it becomes public information within 15 minutes of execution. And so Fidelity is just constantly pulling down recent trades from that repository and making it available to you. Because if a bond is recently traded and it's a reflection of where you are in terms of being on the same side of the market, it might be informative to say, all right, if I'm going to buy this CDF bond at the ask price of 99.108, is that a fair and reasonable price?

One way to figure that out is where is it recently traded. So if there's been a recent purchase today and it's at 99.2, then 99.108 doesn't look so bad. So it's just a way to pull things together to do price discovery and some due diligence.

Now, some of those aspects are going to be carry over into the municipal market. So we'll show some of the similarities and differences. But when we think about the municipal market, so municipal bonds, if you think about the state or the community that you live in and are joining us from today-- I'm here in the city of Boston.

So the city of Boston issues bonds. State of Massachusetts issues bonds. The water authority for the city of Boston, issues bonds, and all of those are tax exempt or not all of them. Many are issued as tax-exempt securities at both the federal level, and depending on the state I live in, I might not pay state income tax as well if it's a tax-collecting state.

And so because of that, the yields tend to be a lot lower because that's what you keep that net. But almost everything else on that yield chart that we saw earlier is taxable. So when we think about the municipal market, it's oftentimes compared to Treasury yields on a ratio basis as a percentage, or a fancy way of saying it would be like relative value. So relatively speaking, what does a Muni yield as a percentage of treasuries?

And this chart has some kind of unique events that have occurred, both to the municipal market and then just generally speaking. But when we think about, for example, the Muni market, there's been concerns around whether or not tax exemption of municipals will stay in place. You had the pandemic, which a lot of folks were concerned about tax receipt collection at the municipal level. So different things can influence municipal yields that may not influence Treasury yields to the same extent. So the dark green is looking at a municipal bond yield for a 10-year maturity, and the olive lighter green is a 10-year Treasury yield.

So in a former life at Fidelity, I worked in our capital markets area, and when I started in the early 2000, I remember my first boss saying like, if I could get 80% of a Treasury yield via a municipal bond, that was good relative value. And that still holds maybe some merits. And you'll see the Muni yield as a percent of Treasury yield on the far right-hand side. But like, for example, right now, that 80% number is on the longer end of the market, whereas something closer to 10 years might be around 70% right now.

I always think about it as I can't change the rate environment. I can't change that the 10-year Treasury is at 3.75 or whatever it is today. But how can I try and squeeze blood from a stone? If I'm in a taxable account, these are-- you'd want to consider these for a non-retirement account where I might be paying a high federal and/or state income tax.

So when you start to try to take that into account, that's the squeezing blood from a stone. Like I can't change the rate environment, but I might have some control on how much I keep net of taxes. And that's where that relative value can come into play.

So as we take a peek at municipal yields, again structure is going to influence things. What you'll notice to the right of the description is that bonds might have different coupons in terms of the amount of cash flow that they pay. The maturities are all pretty similar, but then those call features might be different. Coupon, call date, maturity, and then the credit rating of the issuer can all influence a range of returns around a certain ballpark time horizon. And there's far more municipal issuers here.

Here it looks like we're looking at a national cross-section. If you think about all 50 states and some of the territories and everything that can be issued, there's plenty of issuers to go around that all have unique profiles to them. We saw this with the corporate market. And so just a few nuances that are slightly different that I want to point out.

So what you'll notice is material events, issuer events. So the name switches a little bit. But again, a material event is if something happens to that issuer where the regulators have identified those events as being material in nature, it's going to flash it as a yes. And so credit quality changes or potential changes are material events. Filing financials or failing to file financials, if you miss your deadline, those are all material events as well.

And when I click on the yes, it's going to pull that data from a repository. So that's similar to what we saw on the corporate market.

One thing that can be different in the municipal market is rating. So the municipal market has something called bond insurance. You don't see as much of this as you used to.

The financial crisis, unfortunately, really wreaked havoc on some of the municipal bond insurers. But for example, this New Jersey bond that we're looking at happens to be insured by Assured Guaranty. Assured Guaranty is, in essence, providing for timely principal and interest payments. Should Hasbrouck Heights, New Jersey, no longer be able to?

And so because of that, an insured bond can have up to two ratings, that of the issuer of the school district in New Jersey and then that of the insurer, not the issuer. If there is no bond insurance, there should be one set of ratings just to reflect that of the issuer. And when you look at the headline rating, it's going to take the higher of the two, but then it allows you to dive deeper to say, what's the issuer level, and what's the insurer level?

When I think about bond insurance, just as a quick note, someone who eats off the menu and buys bonds herself, this is insurance that I don't want to use. This is like car insurance. This isn't like health insurance where you know you're going to be a participant in using it.

Bond insurance is used of like car insurance when things go wrong. So you think about, do you really want to be relying on insurance, or would you rather be a good driver? So keep that in the back of your mind. All right.

So when I think about looking at recent trades, in addition to being able to look at that chart, which showed the time at which trades occurred and what side of the market it is, if you're a visual person and prefer to see it as a chart, just know that that's available to you for both corporate and municipal bonds. So we're just kind of showing this in a graphic view as opposed to a tabular one. Again, that's a preference piece.

And then one thing I do want to touch on is pricing. This is always something that comes up, which is-- again, how do I know I'm getting a fair and reasonable price? I can look to see recent trades. I can look at depth of book to see if there are other firms offering the same bond or bidding it.

But in addition, Fidelity will commission a pricing study[1] to in essence, secret shop tens of thousands of bond trades to see at that time, what was the same bond available at the same time? What's the price difference versus, like secret shopping? And we'll update the results.

And so these are kind of hot off the press at this point. And because Fidelity is using that kind of portal approach where we're pulling other firms' inventory, we're not committing as much from our own balance sheet to stock the shelves. So it allows us to keep the cost of accessing the market down to what I would consider a bare minimum, $1 a bond.*

And again, it's kind of pulling. We're a conduit, pulling together other firms inventory, which might include Merrill Lynch, Morgan Stanley, and Wells Fargo, which are listed to the left, where they are committing capital to stock the shelves. And as a result, there's a cost to that capital commitment.

And they operate a slightly different business model and say we want to make $11, $14 or $15 a bond versus $1 a bond. So just know that similar to other aspects of Fidelity, we want to be able to provide value, open architecture, and let firms like Morgan Stanley, Merrill Lynch, and Wells Fargo compete for your trade by seeing that anonymous view on depth of book and offerings like that.

Separately-- and I know Jonathan had previously mentioned that we'll have PIMCO on tomorrow-- we'll try to leverage other third-party opinions to help inform your points of view, whether it's leveraging PIMCO or BlackRock and some of our research. Zacks is oftentimes a frequent contributor as well. It's not just about getting Fidelity's opinion, but others as well. And I know Jonathan and his team are great about having other participants as part of the webinar series so that you're hearing from more than just us.

***Minimum markup or markdown of $19.95 applies if traded with a Fidelity representative. For U.S. Treasury purchases traded with a Fidelity representative, a flat charge of $19.95 per trade applies. A $250 maximum applies to all trades, reduced to a $50 maximum for bonds maturing in one year or less. Rates are for U.S. dollar-denominated bonds; additional fees and minimums apply for non-dollar bond trades. Other conditions may apply; see Fidelity.com/commissions for details. Please note that markups and markdowns may affect the total cost of the transaction and the total, or "effective," yield of your investment. The offering broker, which may be our affiliate, National Financial Services LLC, may separately mark up or mark down the price of the security and may realize a trading profit or loss on the transaction.**

So as we come to the final piece of this, it's looking at strategies for managing wealth and what type of bond tools are available to you for those strategies. One question that you always kind of want to ask yourself is, why am I buying bonds? Like, what purpose are they intended to serve? And for some folks, it's just part of a long-term asset allocation. I think about, I buy stocks because I want to get wealthy, but I want to buy bonds because I want to stay wealthy.

When I take it back to the why, if I buy a Treasury or a high-quality municipal bond here in Massachusetts, in a perfect world, I know exactly what I'm getting and what I'm getting it. And that allows me to keep my wealth rather than try to create new wealth that I might be doing in the equity market or hopefully doing in the equity market.

There are also potential situations where you may want to use bonds to almost like match assets with a liability like college education. You may be saving for a child or a grandchild or another family member, and you think, OK, I anticipate at the age of 18, they're going to go to college. You can kind of map that out.

So a good example might be I want to leverage bonds for tuition expenses. But even before we get to that, when we talk about knowing what I'm getting and when I'm getting it, I invest a certain amount today. I get semiannual interest payments more often than not.

And then on maturity or the call date, I get my last interest payment and my-- the return of principal. That's a big series of cash flows for each bond. And if I buy a series of them, I'm going to be getting something on the righthand side, which is a ladder, where I staggered my maturities.

And so I could use that to set aside funds for college. I might get interest payments in between when I invest and when the child's going to college. But I could set aside funds for hopefully for years, and not something longer, of college expenses.

This was a slide that was probably pretty popular two years ago, a year and a half ago, which is I'm concerned that rates are going to go up, and I want to be able to take advantage of that. So we talked about, when you're at the end of a rate cycle and you want to preserve yield, you would think about adding maturity versus subtracting it.

When I think the exact opposite is true, if I think rates are going to be rising and I have high conviction around that, I may want to keep my ladder really short so I can turn it over sooner rather than slower and capitalize on that rising rate environment. So that could inform a strategy.

If I wanted to mitigate the risk of the equity market and volatility in that, I might decide to try and integrate higher-quality bonds in my portfolio. Quality is king. So that's something that can oftentimes come up. Sorry, kind of got away from one of the pieces of the page there. I may have, for example, concentrated positions where I want to work around things or potentially rebalance.

I know there's been a lot of updates to our fixed-income dashboard over the last couple of months, which provide a lot more visibility into sectors, concentration in different types at the-- I know there's a CE webinar coming up soon, even FDIC insurance concentration. So there's a lot of different concentration types that you could potentially try to plan around using the fixed-income dashboard.

To recap where we've been, we've talked a little bit about the macroeconomic trends. We just had the Fed cut rates a half a percent last week. They've largely given us the answers to the test for the rest of the year, which is they expect to cut another half based on the dot plots.

Now, obviously, there's economic events or geopolitical. There's always something that could potentially cause them to deviate. But based on what we know to be true today, that's what they're anticipating.

Secondly, we talked about three aspects of fixed-income investing that Fidelity believes are quite important, and I happen to share that view, which is having an understanding of the yield curve and what that might be telling us, that not all bonds are created equal. There's sectors or subasset classes, and they do different things at different times. And within any segment of the market, there could oftentimes be a wide range of yields within that.

We looked a little bit at the corporate market and the municipal market in greater detail, specifically around price discovery, being able to see where bonds have recently traded. Are there multiple firms that Fidelity is connected to that could provide some pricing advantages depending on the size that you're trading? That's true in both the corporate, the municipal, also the Treasury market.

And then thinking through material events. If something looks a bit off from a yield perspective, is there something out there from a ratings perspective that might inform whether or not I think about actually buying that bond or not? And do I feel it's compensatory? And then a little bit around strategy.

Now, as we kind of think through that, what are some of the next steps? We've got some other great content coming up in the next couple of weeks. I know I'm personally very excited to hear Dr. Bernanke tomorrow talk about where his views are, especially in light of being able to get them right after a Fed rate cut is fantastic. So having an updated view from folks like PIMCO or discussing brokered CDs the following week could be great. There's tons of self-paced learning and archive webinars that are available to you.

But let's say this conversation today inspires you to want to take more action more imminently. It could be if you're working with a financial consultant locally, reaching out to them, asking, how does this fit into my plan? Speaking with one of our fixed-income solutions specialists at the 800 number listed below-- that team is a fantastic resource during the week from 8:00 AM to 8:00 PM Eastern.

And as we go through the last piece here, we're obviously always grateful that we have a chance to get in front of you to share our thoughts and views. And hopefully, you found some value in today's conversation.

JONATHAN LAMOTHE: So with that, we got a lot of great webinars coming up. Be sure to visit fidelity.com/webinar, and we look forward to seeing you again on some future webinars. Thank you again, Danielle.

DANIELLE FOX: Thank you.

Footnotes:

[1] https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/BondPricingStudy.pdf

Fidelity commissioned Corporate Insight to study bond pricing, available online, for self-directed retail investors from three brokers that offer corporate and municipal bonds for comparison to Fidelity's standard online pricing. The study compared online bond prices for more than 37,000 municipal and corporate inventory matches from June 4 through July 10, 2024. It compared municipal and corporate inventories offered online in varying quantities. The study found that, on average, the three online bond brokers identified in the chart were asking $12.95 more per bond. Corporate Insight determined the average price differential by calculating the difference between the prices of matching corporate and municipal bond inventory at Fidelity, including Fidelity's $1 per bond markup for online trades vs. the prices offered online for the same bonds from the three brokers in the table, then averaging the differences of the financial services firms. The analysis included investment grade corporate and municipal bonds only.

Disclosures

Views expressed are as of the date indicated, based on the information available at that time, and may change based on market or other conditions. Unless otherwise noted, the opinions provided are those of the speakers and not necessarily those of Fidelity Investments or its affiliates. Fidelity does not assume any duty to update any of the information.

References to individual securities are for illustrative purposes only and should not be construed as investment advice.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Any fixed income security sold or redeemed prior to maturity may be subject to loss.

Interest income earned from tax-exempt municipal securities generally is exempt from federal income tax and may also be exempt from state and local income taxes if the investor is a resident in the state of issuance. A portion of the income received may be subject to federal and state income taxes, including the federal alternative minimum tax. In addition, investors may be subject to tax on amounts recognized in connection with the sale of municipal bonds, including capital gains and "market discount" taxed at ordinary income rates. "Market discount" arises when a bond is purchased on the secondary market for a price that is less than its stated redemption price by more than a statutory amount. Before making any investment, investors should review the official statement for the relevant offering for additional tax and other considerations.

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Past performance is no guarantee of future results.

A bond ladder, depending on the types and amount of securities within it, may not ensure adequate diversification of your investment portfolio. While diversification does not ensure a profit or guarantee against loss, a lack of diversification may result in heightened volatility of your portfolio value. You must perform your own evaluation as to whether a bond ladder and the securities held within it are consistent with your investment objectives, risk tolerance, and financial circumstances. To learn more about diversification and its effects on your portfolio, contact a representative.

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