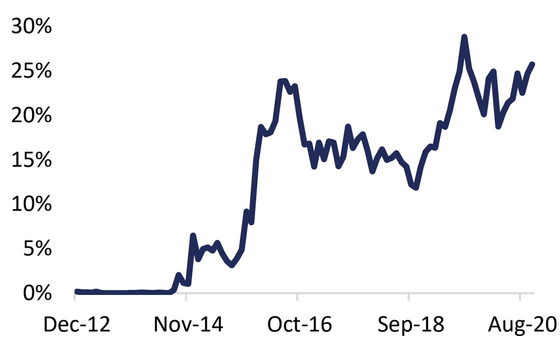
December 7th, 2020

Fixed Income Three-Ways

Today calls for a Balanced approach to Fixed Income
The discussion of the role of fixed income in portfolio allocation, given historically low global yields, has hit a fevered pitch. Most recent academic and street research has focused on the limitations of fixed income as a reliable hedge to stocks, thereby casting doubt on the benefits of fixed income within a larger multi-asset portfolio. However, fixed income should neither be thought of as one uniform asset class, nor solely as a hedge.

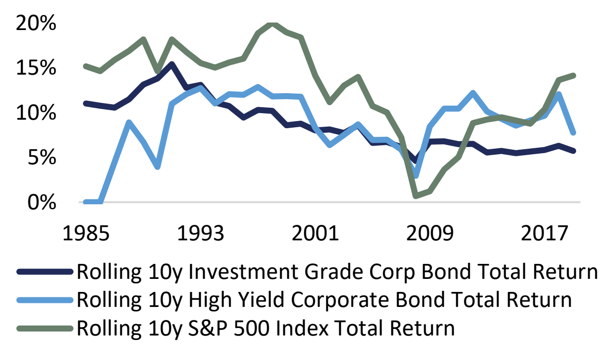
Navigating a low yield environment is not a new challenge. Since 2016 nearly 25% of the world's fixed income products have carried a negative yield (Chart 1) and corporate bond returns have nonetheless delivered mid-to-high single-digit returns (Chart 2). In fact, over most of the last 40-year bull market in fixed income, corporate bonds have generated equity-like returns with less volatility. The days of outsized total returns are likely gone for the foreseeable future, but careful and thoughtful allocation within the $100 trillion fixed income market should provide continued opportunities for almost any investor.

Chart 1: 25% of Global Fixed Income has a negative yield



Source: ICE BofA Fixed Income Indices

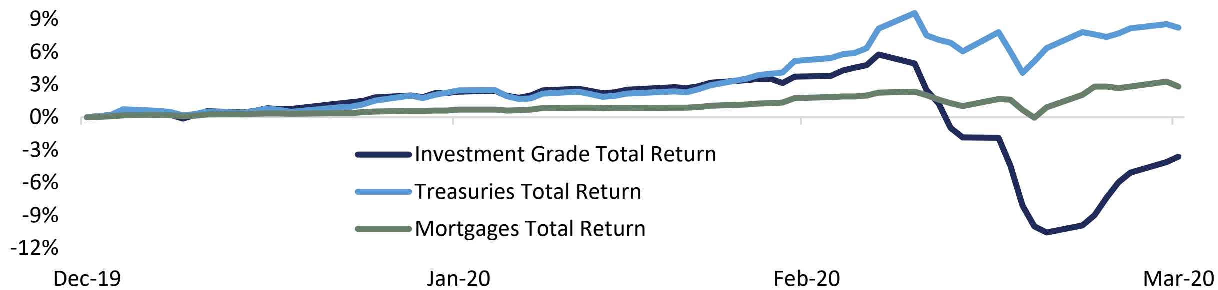
Chart 2: Corporate bond returns have delivered equity-like returns during the fixed income bull market



Source: Richard Bernstein Advisors LLC, Bloomberg, Bank of America Merrill Lynch Global Research

One size doesn't fit all
The key to fixed income investing is understanding fixed income is a collection of assets with unique features and utilizing the right instrument at the right time. **Chart 3 shows that different segments of fixed income can have dramatically different returns during the same period.** For example, in the first quarter of 2020, investment grade credit returned -3.0%, mortgages returned +2.8% and treasuries returned +8.2%. Indeed, rather than taking a 1 or 2 dimensional view of how fixed income should be used within a portfolio (tax benefits or market hedge), with proper asset selection and active management, a skillful investor can use fixed income to enhance portfolio returns, insulate a multi-asset portfolio from an economic downturn, and/or provide additional balance during uncertain times.

Chart 3: Returns in Q1 2020 varied across corporates, treasuries and mortgages

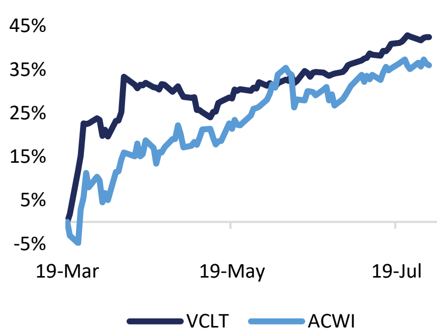


Source: Bloomberg

As Chart 4 shows, through proper asset selection, fixed income can deliver excellent total and risk-adjusted returns alongside equities: Long-dated investment grade corporate bonds from March through July returned 42%, outpacing the 36% total return in the ACWI Index. Conversely, skillful active management can help hedge poor equity performance – even within a low-rate environment - as long-dated Treasuries did earlier this year (Chart 5).

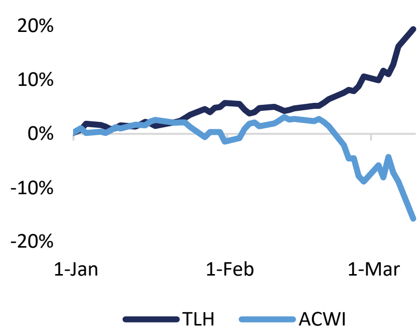
The environment today seems to warrant a more “all-weather” fixed income approach to complement a larger balanced equity portfolio. Chart 6 highlights that a 50/50 portfolio balancing credit risk (IGBH*) with medium to long-term Treasuries (TLH*) would have returned 2.1% since September 1st - outperforming the Bloomberg Aggregate index by 180bp - with the credit portion providing exposure to the recovery and the Treasuries acting as a ballast during periods of volatility and uncertainty.

Chart 4: Risk On: From Mar-Aug, long dated corporate bonds (VCLT) outperformed ACWI



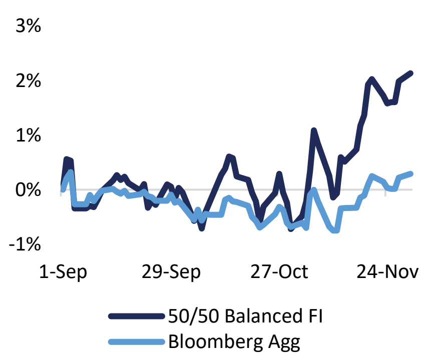
Source: Bloomberg

Chart 5: Risk off: From Jan-Mar, long-dated treasuries (TLH*) outperformed ACWI



Source: Bloomberg
*the security is currently held in a portfolio managed by RBA

Chart 6: Since 9/1, a balanced FI portfolio has outperformed the Bloomberg Agg



Source: Richard Bernstein Advisors LLC, Bloomberg

Balancing the portfolio between credit risk and rate risk while complementing other areas of a broader portfolio is the key to allocating in fixed income. And as the economy improves – and profits, liquidity and sentiment become more attractive – there will be plenty of areas of opportunity to provide outsized returns and attractive income, while still providing a hedge against rising US rates.

Fixed income may be down, but we don’t think it’s out.

*the security is currently held in a portfolio managed by RBA.

Michael Contopoulos
Director of Fixed Income

Please feel free to contact your regional portfolio specialist with any questions:
Phone: 212 692 4088
Email: sales@rbadvisors.com

For more information About Michael Contopoulos, please click here.

INDEX DESCRIPTIONS:

The following descriptions, while believed to be accurate, are in some cases abbreviated versions of more detailed or comprehensive definitions available from the sponsors or originators of the respective indices. Anyone interested in such further details is free to consult each such sponsor's or originator's website.

The past performance of an index is not a guarantee of future results.

S&P 500®: Standard & Poor's (S&P) 500® Index: The S&P 500® Index is an unmanaged, capitalization-weighted index designed to measure the performance of the broad US economy through changes in the aggregate market value of 500 stocks representing all major industries.

Bloomberg Aggregate Index: **The Bloomberg Barclays US Aggregate Bond Index** is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

ACWI Index: **The MSCI ACWI Index**, MSCI's flagship global equity index, is designed to represent performance of the full opportunity set of large- and mid-cap stocks across 23 developed and 27 emerging markets. As of November 2020, it covers more than 3,000 constituents across 11 sectors and approximately 85% of the free float-adjusted market capitalization in each market. The index is built using MSCI's Global Investable Market Index (GIMI) methodology, which is designed to take into account variations reflecting conditions across regions, marketcap sizes, sectors, style segments and combinations.

VCLT: **Vanguard Long-Term Corporate Bond ETF** is an exchange-traded fund incorporated in the USA. The Fund seeks to track the performance of the Bloomberg Barclays US Long Corporate Bond Index.

TLH: **iShares 10-20 Year Treasury Bond ETF** is an exchange-traded fund incorporated in the USA. The ETF seeks to track the investment results of an index composed of U.S. Treasury bonds with remaining maturities between ten and twenty years.

IGBH: iShares Interest Rate Hedged Long-Term Corporate Bond ETF is an exchange traded fund incorporated in the USA. It seeks to mitigate the interest rate risk of a portfolio composed of U.S. dollar-denominated investment-grade corporate bonds with remaining maturities greater than ten years.