Rochester Wealth Strategies

439 S Main St, Suite 250
Rochester, MI 48307
(248) 434-6550

Market Talk with Mike Skoric

This year finally brought about the end of a bull market in bonds that has lasted several decades. With bonds, when prices go up yields go down, leaving income-oriented investors desperate in their search for replicating prior levels of bond income. In practice this pushed many investors to diversify out of investment grade bonds into other sub-asset classes, including high dividend paying stocks. But there were also shifts into the riskier segments of the broader fixed income universe. This includes high-yield bonds that have sub-investment grade credit ratings and carry higher levels of risk. In addition, investors increased or initiated allocations to emerging market bonds, convertible bonds, and higher-yielding preferred stocks. While the driver of these diversifying fixed income was the mentioned search for yield, the net result was fixed income portfolios that had much more interest rate, credit, and even foreign currency risk than ever before.

Our company, among many, has participated in the utilization of this expanded fixed income universe. However, given the dramatic jump in inflation over the past year and the resulting spike in interest rates – we see yields returning to more normal and certainly much more enticing levels. We are now able to achieve expected yields without being excessively allocated to some of the bond categories mentioned above. This has allowed us to gradually increase the allocation to our core fixed income positions and decrease allocations to higher-risk areas such as high yield or emerging market bonds. Given our belief that inflation is in the process of peaking and that yields are at or near their highs for this cycle – we are modestly extending our average portfolio maturity levels to take advantage of the higher yields.

As an example of the opportunities provided by this new bond market, we have investment grade corporate bonds that are yielding around 6% with five-year maturities. For higher-income investors in taxable accounts, we can find similar-maturity municipal bonds yielding over 4%, which result in a tax-equivalent (after-tax) yield of over 6%. The current yield levels are in some cases double or even higher compared to the levels prior years. This bodes well for bonds and increases our confidence that the asset class can be counted on to provide attractive income and total return with much lower levels of volatility compared to stocks. While the equity market continues to look for direction in this higher inflation environment with a slowdown in earnings growth and fear of a recession, there are reasons for optimism in the fixed income space. We look forward to an extended period of time of higher yielding bond market opportunities.