

BONDS DELIVER SOLUTIONS FOR 6 CORE CHALLENGES

In today's dynamic markets filled with endless investment options, bonds remain an important consideration when addressing investors' core concerns. Over the last decade investors have enjoyed positive stock market returns while the range of alternative investment opportunities has grown. However, it's important to review the essential role that bonds perform in client investment portfolios and how they can help address investors' concerns.

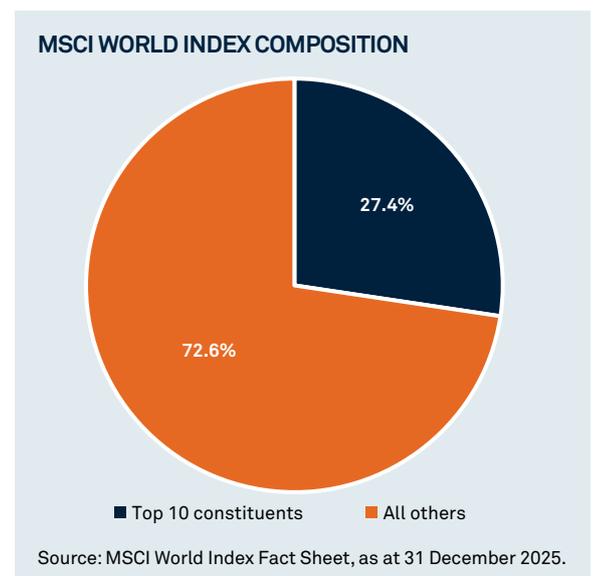
High Equity Valuations

While investors are increasingly concerned with the high equity valuations in US markets, it is difficult to ignore that the level of absolute yields available in bond markets is at the highest seen before the global financial crisis, especially at longer maturities. This means bond markets offer a compelling, income-based return.

If equity markets were to fall sharply, interest rates could decline, and this could also present the opportunity to generate capital gains from bonds.

Increasing Concentration Risk

With equity leadership concentrated in a few names, an active fixed income manager will typically build a highly diversified portfolio of debt issued by many different companies or governments. This makes bond portfolios far less reliant on the performance of any single company. To illustrate this striking difference in diversification, the Bloomberg Global Aggregate Bond Index¹, a flagship global fixed-income benchmark, comprises over 31,000 individual bonds. The top 10 holdings represent less than 1-2% combined. By contrast, the MSCI World Index² includes around 1,300 constituents, yet the top 10 account for over 25% of the index weight.



¹ The Bloomberg Global Aggregate Bond Index is a comprehensive measure of the global investment-grade fixed-income market, encompassing government, corporate, and securitized bonds from both developed and emerging markets.

² The MSCI World Index is a global stock market index that captures large and mid-cap representation across 23 developed markets.

Risk of Equity Market Losses

Fixed income markets have historically been far less volatile than equity markets. Periodic coupon payments deliver reliable income streams, adding a cushion which can smooth overall returns.

Some higher-risk parts of fixed income markets, such as high yield credit, have generated returns comparable to other growth assets, but have historically experienced shallower drawdowns and faster recoveries than equities during periods of crisis.

Recession Potential

When economic growth and profit durability are in question, bonds offer a different dynamic: they don't need evidence of profit growth to return capital and, if a recession prompts central banks to reduce interest rates, bondholders can benefit from potential capital gains.

Unknown Risks

Fixed income markets offer investors a broad range of assets with varying prospects for risk and return. This allows an investor to choose a fund that better fits their risk and return profile.

For example, bonds with a shorter term to maturity are usually less sensitive to interest-rate changes than longer-dated bonds. This can reduce the potential for volatility.

Some investment approaches may seek absolute returns, which can help to significantly reduce the risk of experiencing capital losses. One example is strategic bond strategies, which invest across global bond markets, with the manager adjusting risk exposure based on market conditions.

Rising Rates

The yield which bonds offer today provides a significant buffer should rates rise. Unlike in the 2022 crisis, a very material rise in yields would be needed for bond returns to turn negative. The graphic below sets out the impact of yield moves on bond returns.



The Application for Bonds

Looking ahead, we see compelling reasons for investors to consider the role of bonds in a diversified portfolio given their relative price stability and the predictable income stream they can offer. Bonds can be particularly attractive for risk-aware investors seeking ways to safeguard their capital from market volatility and/or looking to protect wealth at or nearing retirement.

Beyond providing regular interest payments – known as coupons – bonds can add to diversification, helping to reduce overall volatility and smooth returns over time. In periods of economic uncertainty or recession, high-quality bonds are typically seen as safe havens, offering a means to mitigate risks.

Furthermore, when interest rates are stable or falling, existing bonds with higher yields become especially appealing, potentially offering the dual benefits of income and capital appreciation. The bond market also offers flexibility, with options including government, corporate, and inflation-linked bonds which enables an investor to tailor their portfolio to their risk appetite and financial goals.

While equities and alternative assets remain vital, in uncertain economic times considering an allocation to bonds can help provide stability, steady income, and diversification, helping investors achieve more resilient and consistent results.

DISCLAIMER

No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment.

RISKS

Asset class comparisons such as comparing equities to bonds have limitations because different asset classes may have characteristics that materially differ from each other. Because of these differences, comparisons should not be relied upon solely as a measure when evaluating an investment for any particular portfolio. Comparisons are provided for illustrative purposes only. Although stocks have greater potential for growth than bonds, they also have much higher levels of risk. With stocks, the prices can rise and fall for a variety of reasons, including factors outside of the company's control. Bonds may be considered relatively safer. Because they're a debt security, they function as an IOU. The company pays interest to the bondholder, and once the bond matures, the bondholder receives the principal bank. Bonds aren't completely risk-free; there is the possibility of the issuer defaulting on its bonds, and if sold prior to maturity the market value may be higher or lower than the purchase value. But compared to stocks, historically there's been less volatility.

Bonds are subject to **interest rate, credit, liquidity, call and market risks**, to varying degrees. Generally, all other factors being equal, bond prices are inversely related to interest-rate changes and rate increases can cause price declines. High yield bonds involve increased **credit and liquidity risk** than higher rated bonds and are considered speculative in terms of the issuer's ability to pay interest and repay principal on a timely basis.

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