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The Impact of Low Interest Rates
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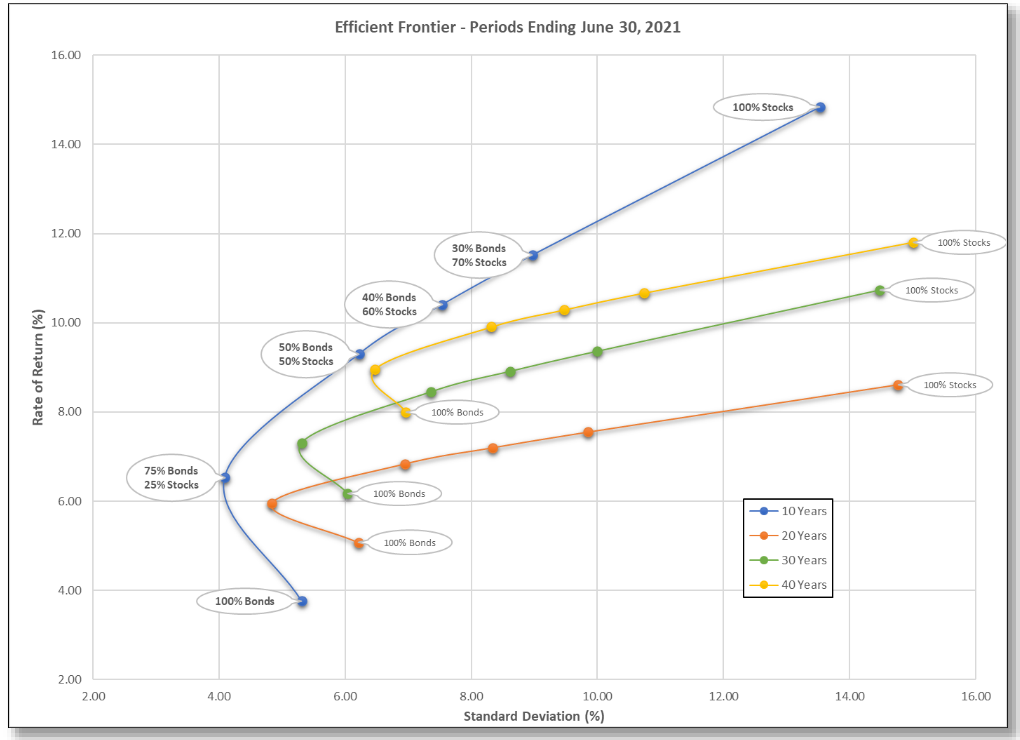
Interest rates continue to remain near historically low levels despite the improving economy and the recent signs of inflation increasing at an alarming rate. As of the date of this writing, the 10-year Treasury has dipped below 1.4% and the Federal Reserve has signaled that they intend to keep short term rates low into late 2022 and possibly 2023**.** With this backdrop, is there a place for bonds in your portfolio?



The chart to the right shows the returns and risk levels (standard deviation) associated with various asset allocation targets over the past 10, 20, 30 and 40-year periods. The yellow line shows data for the past 40 years (June 30, 1981 – June 30, 2021). During this period, stocks (S&P 500) returned 11.81% per year with a standard deviation of 15.01% (higher standard deviation = more volatility). A mix of 70% stocks and 30% bonds for the same period produced an annual return of 10.67% (90% of the stock market return) with 28% less volatility (standard deviation of 10.74%).

The blue line in the chart looks at the most recent 10-year period (June 30, 2011 – June 30, 2021) which has been dominated by historically low interest rates. A 100% stock portfolio returned 14.84% per year with a standard deviation of 13.53%. A 70% stock/30% bond portfolio returned 11.52% (78% of the stock market return) with a standard deviation of only 8.97% (approximately 34% less volatility than stocks).

The low interest rate environment of the past several years has pushed a significant amount of money into stocks that might otherwise be in bonds or CDs. But even with this “distortion” or “risk-on” trade, the data indicates that some bond exposure, even in this low rate environment, can significantly reduce the overall volatility of your portoflio while still allowing most investors to reach their investment objectives. The reason for this is the negative correlation between stocks and most bonds . Put another way, bonds act as a “shock absorber” when the stock market declines, smoothing the ride over the long term. While the data would indicate it might be appropriate to lower bond exposure in order to make more aggressive return objectives, bonds can still play a signifcant role in lowering the overall volatility of your portfolio.