The Price Is Right

Who doesn't love buying things on sale? Finding something you simply have to have at a discount feels good, stretching those hard-earned dollars a little further. Tires, paper towels, suits, shoes, no matter how mundane the purchase we all want to buy on the cheap. Which brings us around to managing balanced portfolios.

Perhaps that feels like a stretch, but at the heart of managing balanced mandates is the process of re-balancing. Selling assets that have appreciated to buy those that may not have performed as well is an integral part of effective portfolio management. The good news for bargain hunters is that fixed income has recently gone on sale. Better still, equity markets have had strong performance over the last year, and those profits offer a ready source of cash for fixed income buyers. Investors should naturally embrace bonds, but especially when they go on sale.

Bonds have several attractive qualities. Firstly, they offer a series of coupons, a fixed income stream, and eventually a repayment in full of their par value. With inflation running at about 1.5%, fixed income investors are currently outpacing the Consumer Price Index. As an added benefit, they reduce portfolio volatility; fixed income returns have historically varied far less than equity returns, as a result balanced mandates have far smoother returns than all-equity mandates. Lastly, bonds are truly the cheapest and, historically, the most effective hedge against stock market declines. The most important reason to re-balance a portfolio and add to the fixed income allocation has little to do with bonds and everything to do with stocks.

Equity markets have moved higher for nearly eight straight years now, with the S&P 500 and the Dow Jones Industrial Average both making new highs and the S&P/TSX has moved to within 1% of its all-time high. With stock markets having enjoyed such success, it is only natural that managers of balanced portfolios are welcoming the opportunity to purchase investment-grade bonds on the relative cheap as part of their natural re-balancing regimen. And their bond-buying dollars are going much further today. Ten-year Government of Canada bonds were offered at 1.72% at year end, up from 0.99% on September 30th; the ten-year A-rated index moved wider from 2.49% to 2.99%, while the lowest rated investment grade bonds – the BBB rated index – moved from 3.24% to 3.65%.

Everyone enjoys buying things on sale, particularly when they are things that they simply have to have anyway. A preferable way to achieve this is to do so over time, with cash flows: adding to fixed income with contributions and reducing stocks with withdrawals. Investment grade bonds are certainly a have to have for balanced investors, and buying both security and cash flows on the cheap is an opportunity that is hard to pass up.