Don't get spooked, it's time to go trick-or-treating

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Drew O'Neil discusses fixed income market conditions and offers insight for bond investors.

Yields have ***risen from the dead*** since their recent lows in mid-September presenting investors with an opportunity that many were ***scared*** had disappeared following the FOMC's 50 basis point rate cut at their last meeting. Treasury yields have been ***creeping*** up and are higher by 50 to 60 basis points from 2 years out to 30 years since September 17. Corporate and municipal yields have experienced ***eerily*** similar moves.

The ***witchcraft*** of bond math dictates that bond prices and yields move inversely. Higher yields means that investors might see losses on their fixed income positions that didn't exist a month ago. Alternatively, small losses may have gotten larger, or gains might have decreased. In any of these scenarios, the most important thing to keep in mind is that these gains or losses are not etched on any ***tombstone*** as they are unrealized. They are nothing to ***scream*** about, as they are simply estimated gains or losses should you choose to sell the bond prior to maturity. The bond is going to be redeemed at par* making any price movement along the way irrelevant. Individual bonds provide a set of unique ***treats*** to investors: a known maturity date, a known maturity value, a known yield, and known cash flows. These key characteristics do not change because the price changed; they are locked in from the date of purchase regardless of changes in interest rates. So ***don't get spooked*** if you see losses on your monthly statement for your fixed income holdings. These are unrealized losses. Assuming you do not choose to sell and lock in this loss, they have no effect on long-term portfolio returns.

Instead, view the recent move higher in yields as an opportunity to go ***trick-or-treating*** around the fixed income neighborhood. Investment-grade corporate bonds in the intermediate part of the curve are over 40 basis points higher in yield since mid-September. Yields in the high 4% to low 5% range are available in BBB rated corporates in the 5 to 10 year window. These are yield levels that were ***hidden away in a crypt*** for a vast majority of the past 15 years. Since October 2009, the average yield of the Bloomberg Corporate Bond Index is ~3.57%. The yield of this index is currently ~5.07%, putting it 150 basis points higher than the average. For 13 straight years, from October 2009 to September 2022, the yield of this index never touched the 5% level and for most of that timeframe was ***buried*** 100 to 200 basis points under the 5.00% threshold. Investors who don't take advantage of this opportunity might be ***haunted*** by their decision down the road.

Municipal yields have seen a similar move higher. The longer half of the municipal curve presents a ***monster*** opportunity for investors in higher tax brackets to ***carve*** out attractive yields. Taxable-equivalent yields in the mid-6% to low-7% range, depending on federal and state tax bracket, are achievable in the 20+ year part of the curve. Similar to their taxable counterparts, these yield levels have rarely been available over the past 15 years. So remember, don't get ***spooked*** by falling fixed income prices. Lower prices mean higher yields which is a ***treat*** for fixed income investors.
**Barring a default*

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