LAWSON KROEKER

As we see it

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"I'm not so much interested in the return ON my money as I am in the return OF my money."
--Will Rogers

The Federal Reserve continues to maintain interest rates at historical lows and equity markets continue one of the longest bull runs on record. A question we frequently field from investors is – Is there still a need for bond investments and balanced portfolios? Before that question can be answered, consideration should be given to the investor's stage of life, wealth accumulation and risk appetite. Investors in the earlier stages of wealth accumulation generally have the time and risk appetite to withstand the equity market's volatility for the expectation of higher returns. In this stage, their quest to grow wealth guides their focus from preserving their capital to growing it.

However, for investors that are farther along in their wealth accumulation, the question of whether bonds should be owned remains valid as their focus shifts toward balancing the stock market's possibly higher returns with the bond market's lower volatility. After periods of strong stock market returns, normally coincident with higher valuation levels, a strong argument could be made to own bonds given their ability to anchor portfolios toward the protection of capital. Afterall, bonds' greatest benefits were their ability to produce income for portfolios, provide stability against equity investment volatility and serve as "dry powder" available as a source of capital to redeploy when stock opportunities arise.

Of the three objectives of holding bonds, the first is currently the least appealing. Interest rates are low and are likely to remain low for the time being, requiring us to adjust our income expectations for bonds accordingly. However, given the stock market's run and the prices of dividend paying stocks and other bond alternatives – whether REITs, MLPs or even farmland - the chase for yield has driven the prices of the alternatives higher as well. Bond yields are low, but so are the alternatives. At least bonds are abundant, easy to trade and if held to maturity, provide the surety of getting your principal back.

While their ability to produce income is currently muted, bonds still firmly hold their ability to dampen volatility in balanced portfolios against the swings of equity holdings. Given current equity price levels, it could be argued that this benefit of bonds is more attractive now than at any point in the last 12 ½ years. If the stock market's ongoing rise seems less certain

> *"You get recessions, you have stock market declines. If you don't understand that's going to happen, then you're not ready, you won't do well in the markets."*
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> *--Peter Lynch*

from current levels, bonds may be an excellent alternative when investors see fewer prospects for returns on their capital. In these instances, Will Rogers may have been ahead of his time.

Finally, a historical reality has been that after major stock market run there is often a correction, and prudent investors benefit when they have cash on hand entering the corrections. Bonds still offer a great place to store capital while waiting for better valuations for equity purchases. While their ability to generate income is currently lower, fixed income investments still offer greater certainty of return of capital. If the stock market's current valuations seem stretched to an investor, balancing their portfolio with bonds may offer a degree of comfort until stock valuations seem more reasonable.

What are the right kind of bonds to own in a low interest rate environment? High-quality issues with short durations are where we have focused recently. Given that the yield curve is not offering much additional reward for buying longer-term bonds, shorter duration investments currently offer the greatest balance of bonds' key investment attributes. Investors are not currently being rewarded for buying longer-term issues and shorter-term bonds offer a greater safety valve and dry powder in any market. At present, they seem the prudent course – until the stock market and longer-term interest rates tell us otherwise.