Ask a Trust Officer

Bonds

DEAR TRUST OFFICER:

How much of my portfolio should be in bonds? A lot more than a couple years ago? — AVERSE TO VOLATILITY

DEAR AVERSE:

Given the wrenching losses in global equity markets of the last few years, a flight by investors to the lower volatility and higher predictability of bonds is to be expected. Perhaps "stampede" would be a better description than "flight." According to *Morningstar Advisor*, open-ended bond funds in the U.S. took in $357 billion in 2009, more than all other asset classes combined and more than the previous five years combined.

Strong demand for bonds, coupled with the Federal Reserve's policy of keeping interest rates low to stimulate the economy, have pushed yields to very low levels. It takes a lot of capital to get much income if aggregate yield is hovering at 3.5%.

Beyond the difficulty of generating income, bond investors have to worry about how the economy will affect the value of their holdings.

Should the economy falter, state and local tax revenues won't be growing and could be falling at a time of increasing demand for state services. Unfunded public employee pension obligations are another storm cloud in this area. These factors could increase the default risk of municipal bonds, depressing prices. On the other hand, rising tax rates in the future could increase the demand for tax-free income.

Strong economic growth won't be unalloyed good news for bond investors either. Once growth becomes robust, the Fed is certain to let interest rates rise back to normal levels. That would push bond prices down, with the biggest declines expected for the longest maturities.

Please contact one of our trust officers at (989) 779-6207 if you are concerned about the role bonds are playing in your portfolio.

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