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Fixed income or bust

As the investment landscape systematically regains some sense of normalcy, investors across the globe are trying to find their footing again.

By leveraging the opportunities presented by the recovery curve, fund managers and financial advisers alike, will be looking at the building blocks at their disposal to add value, structure income funds and bring balance to their clients' portfolios, be it traditional, alternative, equities or fixed income.

Asset allocation and cash flow

Although the current crisis disrupted this landscape, equities and fixed-income investments have mostly worked counter-cyclical and, as equities rally, bond yields generally fall. Every investor's needs are unique, and every investment must be analysed in the context of the broader asset allocation and cash flow requirements of that investor.

From a risk-mitigation perspective, fixed-income instruments continue to offer a level of certainty so, although there is no denying the volatility of the last year, the principles are the same and the adage that diversification is key remains true.

The pandemic impacted every asset class. Even equities with low volatility and dividend yields were affected as companies were forced to withhold dividends. However, it is important to remember that this was an anomaly and, internationally, many of these investments have started stabilising again. This is where building a portfolio consisting of diversified local and offshore assets, that allow investors to weather the storm in the short term, becomes even more important in the long term.

Bonds yield a positive return

Over the past decade bonds have more often been ranked in the top half of asset class performers than not. The absolute nature of bond returns has also seen bonds yielding a positive return in eight of the past 10 years with the second-lowest volatility ranking. With their delinked correlation to the stock market, they have played a crucial role in investors' asset allocation strategies. While some question whether their past track record will translate into the future, bonds tend to be stronger performers in the low-growth environment of South Africa, where capital appreciation on equities has been low. The right question to ask is has the market performed to its expectation over the last decade and how will it perform in the next?

Certain fixed income failures of the past leave a longer-lasting mark in our memory and influence market sentiment. Loss aversion is an endemic, but not always a rational one. The fundamentals of bond instruments are leveraged in the interest rate outlook and cycles, and the price of a bond is inversely correlated to the level of interest rates. If you hold a bond and interest rates rise, the price of that bond can reduce in value.

Globally, over the past decade, however, annualised losses in the bond market have not exceeded more than 3% or 4% so, the downside risk is far less volatile than the equity market. An overreaction to market volatility could result in investors making rash decisions and trading out before the value can stabilise, rather than taking comfort from the certainty of a fixed-interest income. A long-term view is imperative, and it is important for not only financial advisers to understand how these instruments work, but for investors to understand how this volatility stabilises over the full investment term.

Sound financial advice

The average investor has become more familiarised with the mechanics of the equity market. The ability to walk into a company's office or read their financials helps investors understand their investment in more real terms.

Fixed income is less tangible, so there is a need for financial advisers to educate investors, help them understand the asset class and assist them in making educated decisions.

Fixed income bonds remain a popular solution for many investors and movements over the COVID-19 period saw these products experience a significant influx. So, even though the events of 2020 had a far-reaching impact on the financial landscape, the recovery curve is here, and the fundamentals and importance of sound financial advice have not changed. ●

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