# Seeds of Opportunity

It seems to be the reality of human existence that societies cycle between periods of relative poverty, to periods of relative prosperity and back again. With this cycle we also seem to move from periods where savers and investors receive a high rate of interest, to periods where a low rate of interest is paid before rates go back up again. Finding happy middle points, where things remain stable, does not seem to be how life plays out.

## Predictability

If you are like most people, you like to know what to expect. In fact, you often want to know in advance what will happen. This is why so many people like it when they receive "guarantees". We like assurances that help us know what to expect. One aspect of bonds that is attractive to investors is the predictable payments of interest and the promise to pay back the principle on a set date in the future. In this way bond investors know what they are getting and when they will receive it, as long as the entity makes good on its promise.

## Dependability

Ever hear the phrase "clipping coupons". In the "old days" some bonds were actually "bearer bonds" that came with interest "coupons" attached to the bond. The investor would detach the appropriate coupon and submit it in order to receive the interest they were due. They could depend on the interest being paid once they submitted the coupon.

One other way that people have come to think of bonds as dependable has to do with the even and steady nature of the income stream. It gets paid on a dependable schedule and at a rate that is steady for most bonds. Yes, many people buy bonds because they find them in general to be dependable.

## Understandability

Investments in stocks, real estate, commodities, futures and options can often be very confusing to investors. They are just hard for people to understand and evaluate. Bonds can also have some complex features, but for the most part the idea of investing money, receiving interest and then getting your money back at some point makes sense for most people. It is easy to understand.

## Where's the Beef

Given these favorable characteristics, what might cause a bond investment to become unattractive? In last month's issue we dealt with the triple threat that inflation, rising interest rates and defaults can have on bond owners. (If you need to see that issue again, just send us an email.)

Though bonds are often thought of as predictable, dependable and understandable that doesn't mean that bond investments have no risk. Right now inflation is modest, interest rates have not increased in a while, and we are not seeing a high level of defaults among issuers. As a result, bonds have done quite well in recent years. However, I think that there very well might be some inflation and interest rate increases in the years ahead. What kinds of bonds might do well in those circumstances?

## Floating Above It

One part of the bond market involves banks selling some of the loans they make. As interest rates change, the interest on these loans can change. Should interest rates go up, the interest rates on the bank loans would also be expected to increase. Investments that include bank loans would be expected to perform better than other bonds (with fixed interest rates) when bond rates go up. Since rates are very low historically, there's a possibility that they will go up in the future, and floating rate investments look attractive in that situation.

## Inflation Emerging

We know inflation as the impact of prices going up. That is very real to us because it hits us right in the pocketbook. Dollars can also lose value as they relate to the currency of other nations. If the dollar lost value against a currency of another country, the value of the bonds in that country's currency would actually become more valuable. Bonds from emerging market countries are another type of bond investment that I think is more attractive, especially since those countries have far lower levels of government debt to deal with.

## Bucking Tradition

If you looked at almost any interest rate chart from the early 1980's to today, you would see thirty plus years of a trend of general interest rates in the United States coming down. For instance, my first mortgage in Hawaii in 1980 was a 14%, 30 year mortgage. By comparison, I refinanced a couple of months ago at a stated rate of 3.5%, thanks in no small part to my friend John Thompson and his capable staff. Many investors in bonds have prospered because both inflation and interest rates have come down during these three decades, causing the value of the bonds they own to go up.

On the other hand, when interest rates and inflation go up, investing in bonds takes on a different look. Even the regulator in our industry, FINRA, recently issued a caution to investors to be careful of buying bonds in such an environment. That doesn't mean that there are no bonds that will make money, rather investors need to be just a little more selective about their bond investments in today's economic circumstances.

## Bottom Line

Bonds have many characteristics that are very appealing to investors looking for investments that can be described as being more "conservative". On the surface, the promise of regular interest payments and the return of the principal invested fits this description. A lot can happen to the value of the dollar and the interest new bonds will pay, while you are waiting to get your money back. It benefits investors to understand what can happen and to adjust the kinds of bonds they consider buying accordingly. I'm very happy to visit with you about the bonds you own and what opportunities look most attractive in the bond market today.

## Your Feedback

I would love feedback on this newsletter. Future issues may include a host of good ideas, insights, specific steps to take financially, life insights and of course "Wit and Wisdom". Most importantly, I'd like it to be of value to you and to encourage an exchange of great ideas and insights. Please send your feedback to:

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