WESTBOURNE
INVESTMENT ADVISORS

INVESTMENT PERSPECTIVE — FOURTH QUARTER 2023

We often discuss why Equities are a vital component to managing for long-term wealth preservation, protection, and growth in the face of inflationary pressures – in fact, Equities are a main ingredient. In this *Investment Perspective*, we discuss a second vital component of client portfolios: Fixed Income. Fixed Income has a significant role in asset management as a source of near-term liquidity combined with low volatility. Fixed Income investments provide two potential benefits – a stream of income, and an offset to the volatility that comes from owning stocks. The downside of Fixed Income is that the rates paid do not typically enhance long-term purchasing power in that these low-risk investments <u>only pay rates marginally higher than the rate of inflation</u>.

"Portfolio theory, as used by most financial planners, recommends that you diversify with a balance of stocks and bonds and cash that is suitable to your risk tolerance." — Economist Harry Markowitz

Fixed Income investments are as their name implies: *investments designed to provide income (not growth) at a fixed rate of return.* Examples of fixed income investments include Bonds, Money Market Funds, CDs, and cash. Fixed Income investments provide low-volatility investments for funds needed in the near-term (say a 3-year timeframe) where volatility risk is not warranted. Unlike stocks, Fixed Income instruments do not provide ownership rights, they represent a loan from the investor to the issuer of the fixed income security. With fixed income investments, the investor does not benefit from a company's growth but also does not tend to experience as much volatility when growth projections change—*as long the borrower has the resources to stay current on its loans.* Following are major categories of fixed-income investments:

Bonds: Bonds are debt instruments where Corporations (or Governments) borrow at an interest rate called the *coupon rate*. The market value of a bond changes over time as it becomes more (or less) attractive to potential buyers relative to underlying risk and prevailing interest rates. Think of a FICO credit score – bond issuers may possess credit ratings that are excellent (low-risk, e.g., AAA rated) or ratings classified as "junk bonds" (high-risk, e.g., "C" rated). Bonds with higher-quality ratings pay lower interest rates, and bonds with shorter duration (time until full repayment) also tend to offer lower interest rates. Bonds pay the coupon rate as interest payments along the way, usually twice a year, and then pay the face value of the loan at bond maturity. A current example of a Corporate Bond from a Schwab brokerage statement - As of close September 26, 2023, per *Charles Schwab*:

NETFLIX INC, 4.875%28 DUE 04/15/28	10,000	96.875

Bonds are typically issued in denominations of $1,000/ bond, this quote represents 10 bonds issued by Netflix. This bond currently trades at 96.875 cents on the dollar, meaning if we were to purchase 10 bonds today, our total outlay would be $9,687.50, plus any accrued interest. Between now and when the bond matures on April 15, 2028, the bond will pay two cash interest payments each April 15 and October 15, amounting to 4.875% ($487.50) per year. When the bond matures on April 15, 2028, it will pay $10,000 cash for the bonds, meaning it paid both the coupon payments of 4.875% per year plus the slight appreciation of the bond price ($10,000 - $9,687.50 outlay). **The total return of this bond between now and April 15, 2028, also known as the *Yield to Maturity*, is <u>5.6% annualized</u>!**

Money Market Funds: A money market fund is a type of mutual fund that invests in highly liquid, near-term instruments that typically invest in high-credit-rating debt securities with a short-term maturity, such as U.S. Treasury bills. Money market funds are intended to offer investors **<u>daily</u>** liquidity with a very low level of risk.

Certificates of Deposit: A certificate of deposit (CD) is a savings product that earns interest over a fixed period where the issuer is typically a bank. CDs differ from savings accounts because the CD must remain untouched for the entirety of the investment period or else there is a penalty for withdrawing funds. CDs typically earn higher interest rates than savings accounts as an incentive for lock-up of these deposits.

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Cash: Cash, as an investment vehicle held in a brokerage or bank account, is a highly liquid short-term obligation, providing a very low return in the form of interest payments relative to other alternatives. In return for this very low return, often less than 0.50%, cash holdings have very low levels of risk and are insured by Federal institutions – FDIC and SIPC up to a limit of $250,000. Cash holdings may be used to fund known short-term expenses as well as emergencies.

GOOD NEWS: Bond and money market yields are quite high right now. The Federal Reserve has raised interest rates considerably in the last two years to combat the high inflation of the Pandemic stimulus, such that recently, Fixed Income has become much more attractive than cash. Cash deposits typically do not keep up with the rate of inflation: ***Holding Cash = Losing purchasing power vs. alternatives*** (e.g., other Fixed Income, equities)

As has been the case throughout history, we believe Equities will outperform Fixed Income over the long-term and Equities are where long-term investment capital should be allocated. However, Fixed Income has a role in short-term portfolio management, and **one simple recommendation, considering Bonds and Money Market Funds are currently offering rates above 5% is:**

DO NOT HOLD CASH IN A BANK OR BROKERAGE UNLESS YOU NEED IT IN THE NEXT SIX MONTHS. YOU ARE LIKELY NOT EARNING THE RATE OF INFLATION. Call to discuss.

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We wish you a wonderful autumn season, with best regards,

Scot E. Labin Joseph C. Wilkinson Jon Levin

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