

# Demystifying Bonds

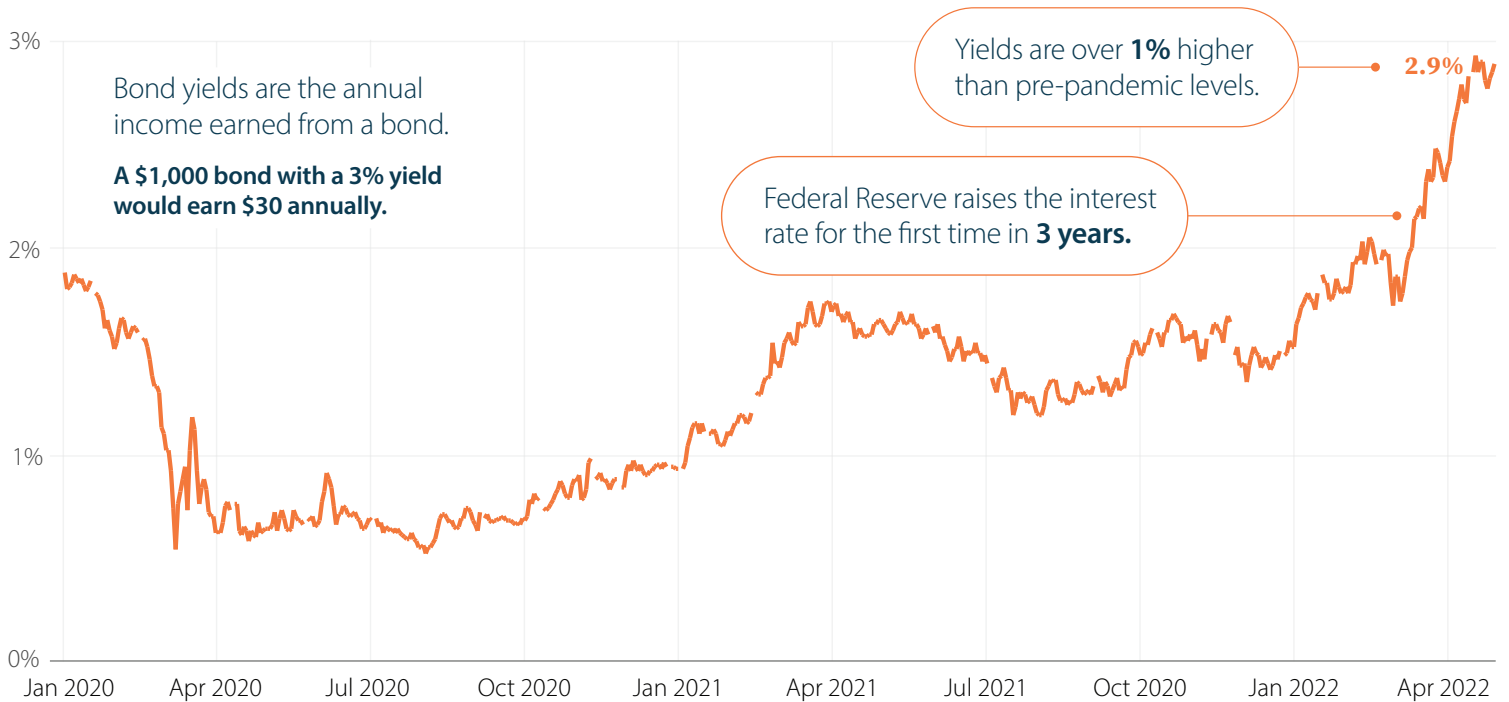
in a Rising Rate Environment



INVESTMENTS

With multiple interest rate hikes on the horizon, some bond investors may be feeling concerned.

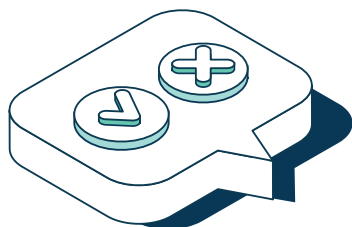
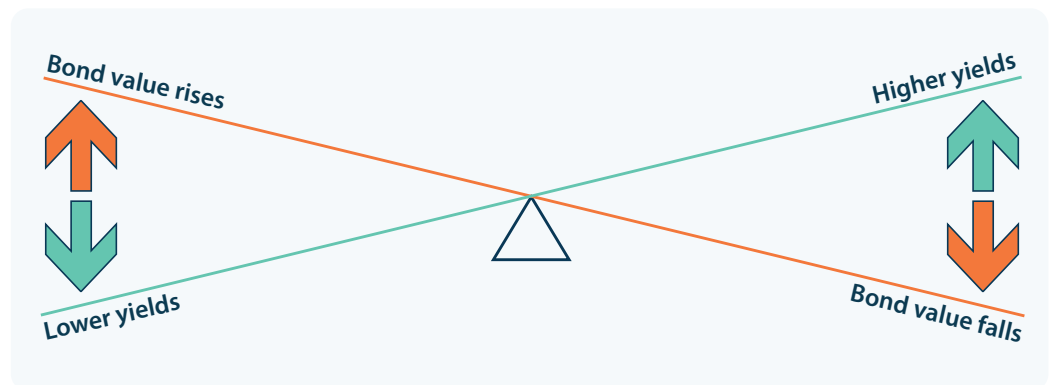
## Yield on U.S. 10-Year Treasury Note



Source: Board of Governors of the Federal Reserve System (Apr 2022)

Rising interest rates directly affect bonds. **When interest rates rise, bond yields typically rise.** Often, this causes bond prices to fall. Why?

As investors seek out bonds that provide higher yields (income), the demand for lower-yielding bonds declines. **Consequently, the price of these bonds typically fall.**



The good news is that the current environment may in fact benefit investors. Below, we debunk three common myths to explain why.

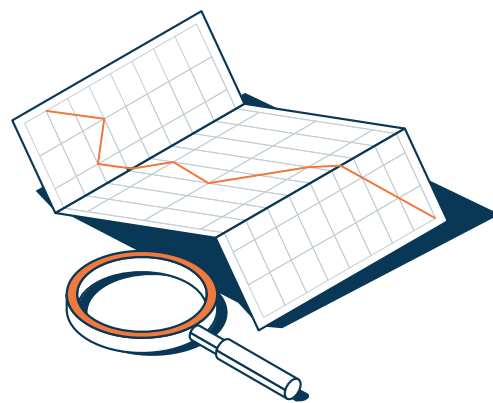
# Myth

# 1

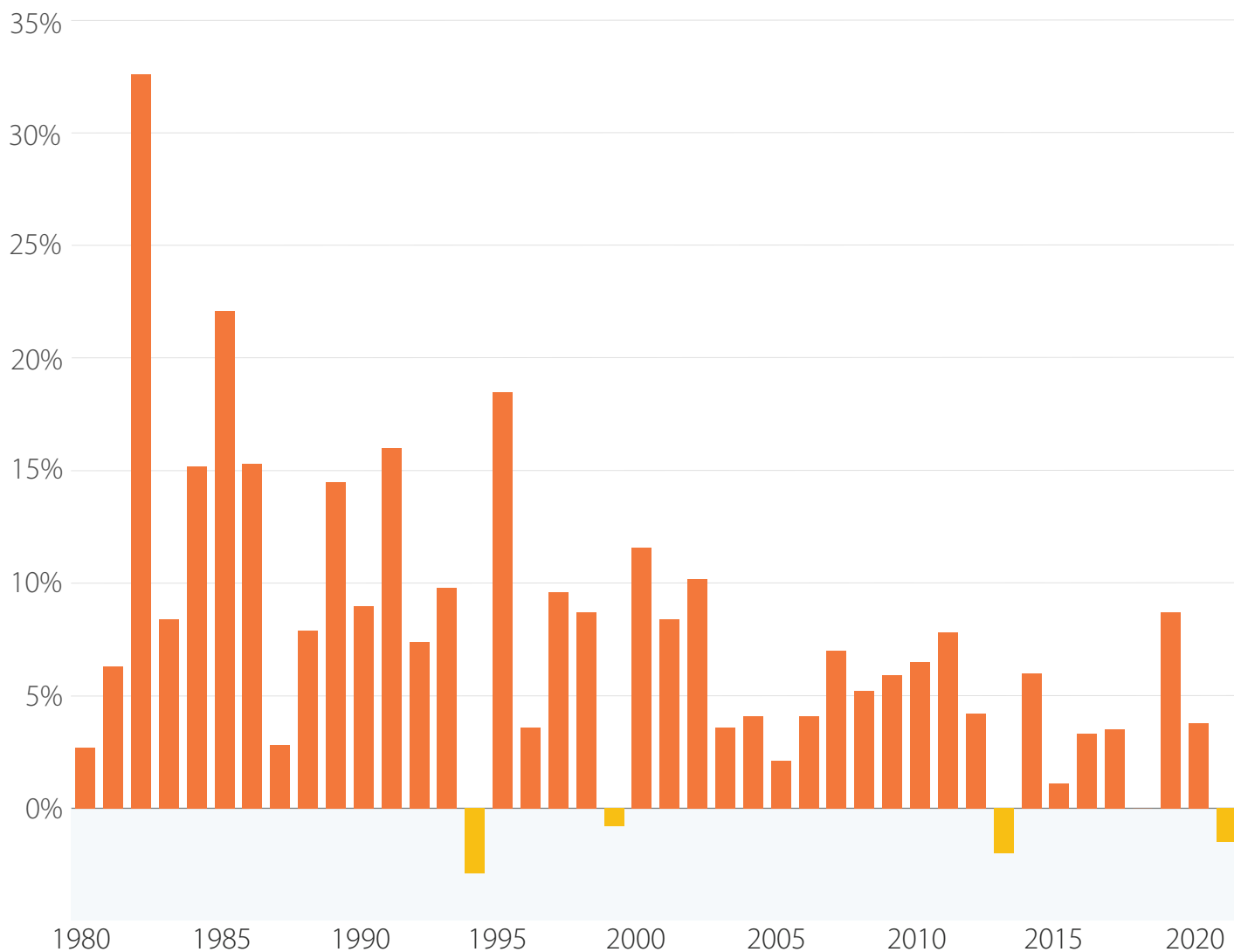
## “Never hold bonds during a rising rate environment”

Answer: **False**

Despite multiple rising rate periods, bonds have shown positive performance in the last **38 out of 42 years**.



### Bloomberg U.S. Aggregate Bond Index

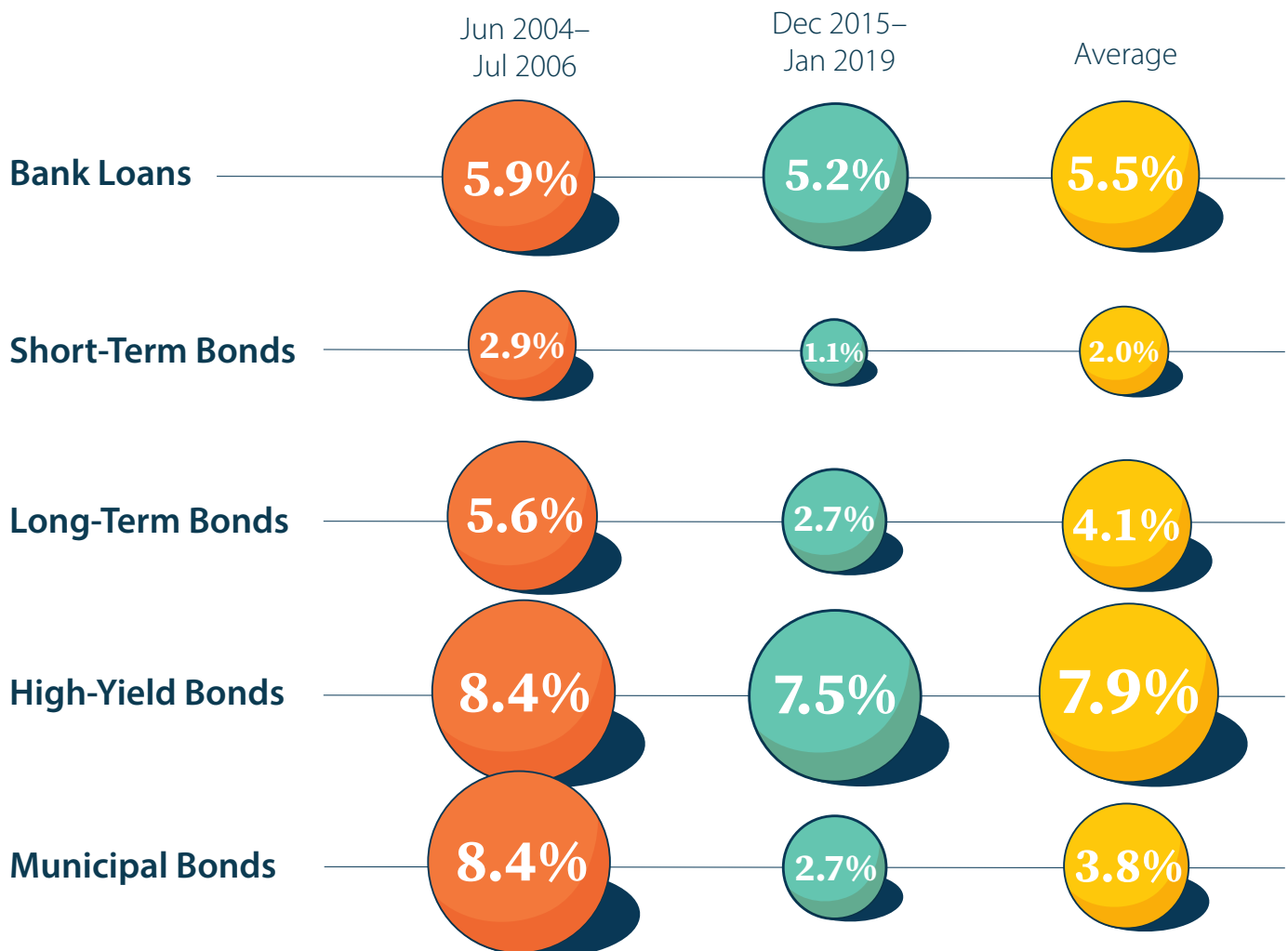


Past performance is no guarantee of future results. An investment cannot be made directly into an index. Index definitions can be found at the end of this piece. Source: Factset (Feb 2022)

# Myth 1

Let's take a look at the **two most recent rising rate periods:**

## Annualized Bond Returns



Source: Morningstar (Feb 2022) Time periods measured from the first Federal Reserve rate hike until one month after the last rate hike, which, on average, is when the effective federal funds rate tends to stabilize. Bank Loans are represented by the Credit Suisse Leveraged Loan Index. Short-Term Bonds are represented by the Bloomberg U.S. Treasury Short Index. Long-Term Bonds are represented by the Bloomberg U.S. Treasury Long Index. High-Yield Bonds are represented by the Bloomberg U.S. Corporate High Yield Index. Municipal Bonds are represented by the Bloomberg Municipal Bond Index. Past performance is no guarantee of future results. An investment cannot be made directly into an index. Index definitions can be found at the end of this piece.

As shown above, bonds proved resilient during periods of rising interest rates.

**Not only that, when equities decline, bonds have often cushioned losses, as seen in the Great Financial Crisis and the COVID-19 market crash.**

# Myth **2**

## “This is the worst time to invest in bonds”

Answer: **False**

Rather than doom and gloom, the current environment could **present a buying opportunity.**



Consider how municipal bonds have performed after historically low periods.

	Peak Date	Trough Date	Drawdown (%)	Return (%) (12 months following trough)
<b>Fed Rate Rise ('04 -'06)</b>	Mar 17, 2004	May 13, 2004	-5.29	+8.65
<b>Subprime Mortgage Collapse/ Global Financial Crisis</b>	Jan 23, 2008	Oct 16, 2008	-11.22	+19.85
<b>Meredith Whitney '60 Minutes' Interview</b>	Oct 12, 2010	Jan 17, 2011	-6.46	+15.20
<b>Taper Tantrum</b>	May 2, 2013	Sep 5, 2013	-6.77	+10.22
<b>Trump Election Victory</b>	Jul 6, 2016	Dec 1, 2016	-5.71	+5.95
<b>COVID-19</b>	Mar 9, 2020	Mar 23, 2020	-10.94	+13.18

**Fed Rate Rise ('22)**

**Aug 4, 2021**

**Apr 30, 2022**

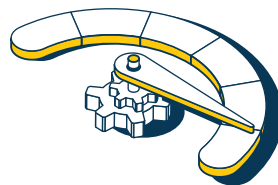
**-9.22**



Municipal bonds represented by Bloomberg Municipal Bond Index. Data is for time period 1/1/1994 to 4/30/2022. A drawdown is defined as the decline from a high peak to a pullback low of a specific investment. Past performance is no guarantee of future results. It is not possible to invest directly in an index. Index definitions can be found at the end of this piece. Source: Morningstar (Apr 2022)

In the 12 months following each trough date, muni bonds **rebounded notably.**

Munis also could potentially benefit from other key factors:



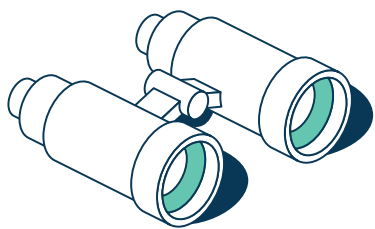
**Solid credit fundamentals**



**\$350B federal stimulus to state and local budgets**

**In short, a “buy low” opportunity may be present not only in munis, but other areas of the bond market.**

# Myth 3



## “The long-term view looks dismal”

Answer: **False**

When taking a long-term perspective, investors could potentially generate **more income** from their bond holdings in a rising rate environment than they would have otherwise.

Here’s how investors can capitalize on rising rates as bonds mature:

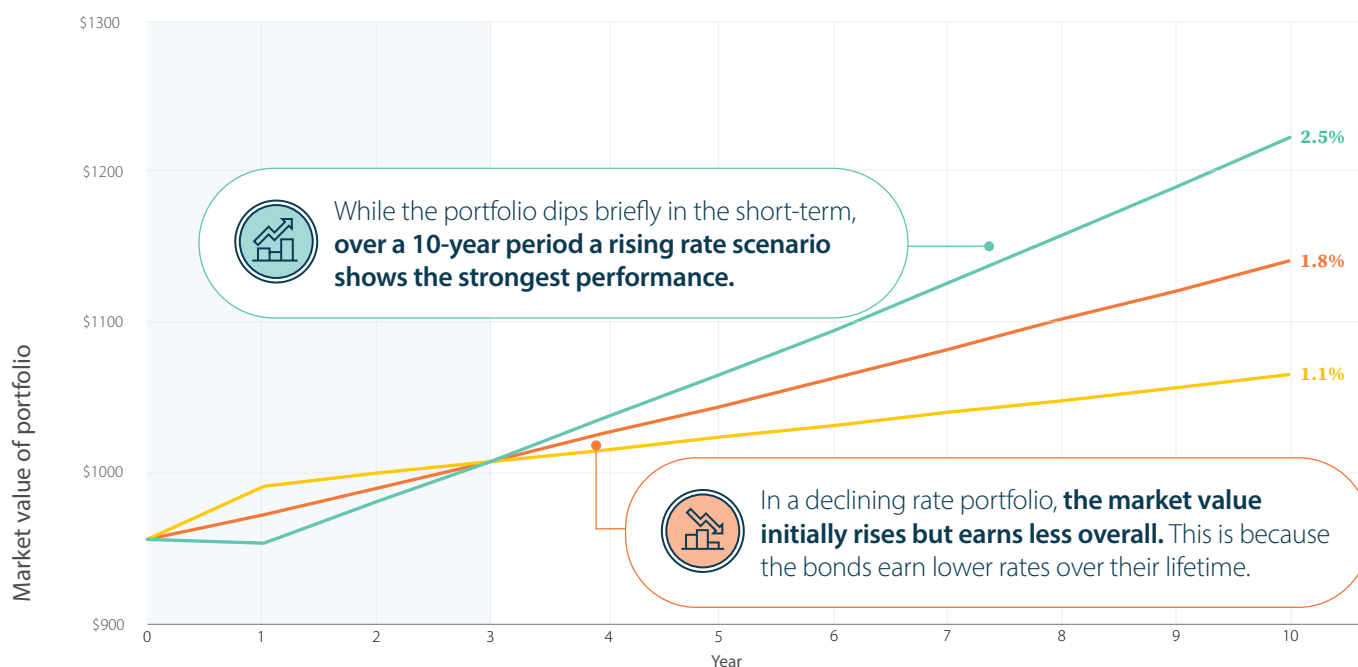
### Assumptions:

**1** Every year, a maturing bond is replaced with a new 5-year bond

**2** The yield is 20 basis points (bps) higher on each new bond

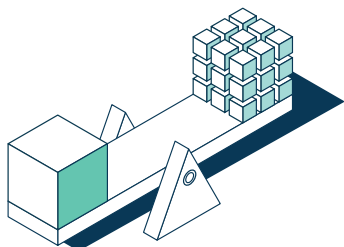
### Annualized Bond Returns

- **Scenario 1:** Yields remain unchanged
- **Scenario 2:** Yields fall 100 bps across the curve during Year 1
- **Scenario 3:** Yields rise 100 bps across the curve during Year 1



Source: RBC Global Asset Management (2020). This example is hypothetical in nature, does not reflect actual investment results, and is not a guarantee of future results. This is for illustrative purposes only and not indicative of any investment. There are certain limitations inherent in hypothetical portfolios and hypothetical results, particularly that they are based on assumptions and do not reflect trading in actual client accounts and do not reflect the impact that material economic and market factors may have had on an actual account.

**By taking advantage of interest rate shifts, active management and a long-term strategy can potentially benefit investors today.**



Active approaches to fixed income have generally outperformed passive strategies by **diversifying across the maturity spectrum and proactively balancing risk and return.**

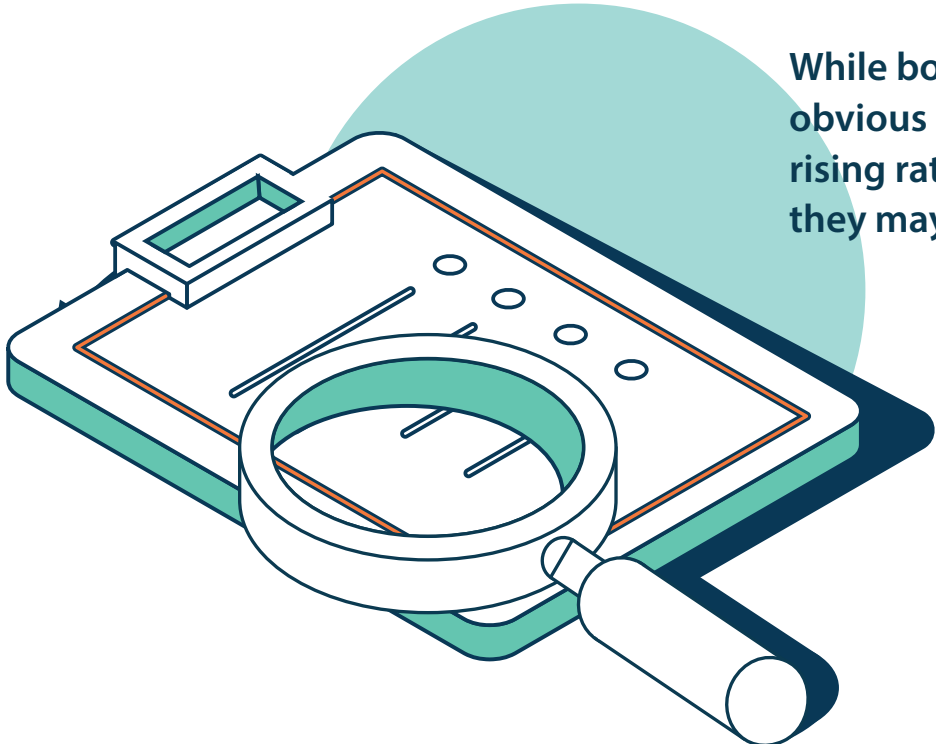
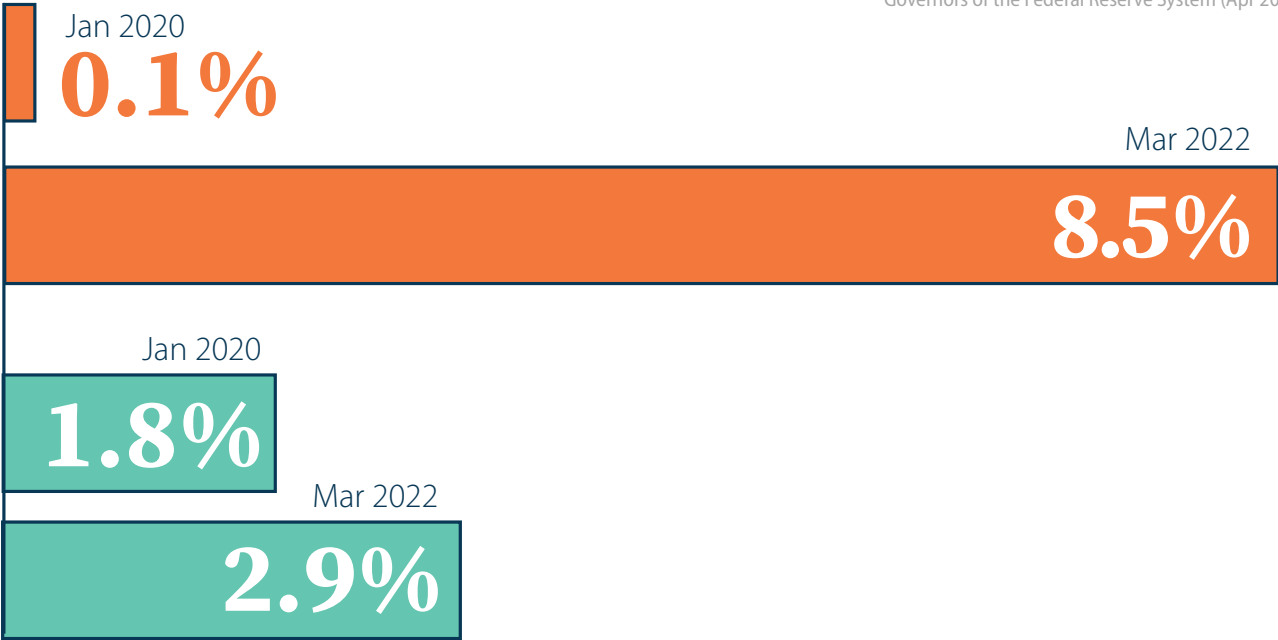
Source: J.P. Morgan (Jun 2019)

# The Case for Bonds

With inflation and bond yields on the rise, purchasing newly-issued bonds at higher rates can help offset this impact.

- Consumer Price Index Year-over-Year Change
- U.S. 10-Year Treasury Yield

Source: Bureau of Labor Statistics (Apr 2022), Board of Governors of the Federal Reserve System (Apr 2022)



While bonds may not seem like the obvious choice for investors amid rising rates, history shows us that they may be worth a closer look.

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Diversification cannot assure a profit or protect against loss in a declining market. The U.S. 10-Year Treasury Yield is the interest rate on the U.S. government debt obligation with a 10-year maturity upon initial issuance.

A basis point (bp) refers to a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%, or 0.0001, and is used to denote the percentage change in a financial instrument. Active management refers to a portfolio management strategy where the manager makes specific investments with an aim to outperform an index. Active management typically charges higher fees.

The Bloomberg U.S. Aggregate Bond Index broadly tracks the U.S. investment-grade bond market including U.S. Treasuries, corporate bonds, municipal bonds, mortgage-backed securities, and asset-backed securities. The Bloomberg Municipal Bond Index is considered representative of the broad market for investment-grade tax-exempt bonds with a maturity of at least one year.

The Credit Suisse Leveraged Loan Index is a representative index of tradable, senior-secured, U.S. dollar-denominated non-investment-grade loans. The Bloomberg U.S. Treasury Short Index is a universe of Treasury bonds, and used as a benchmark against the market for shorter-term maturity fixed-income securities. The Bloomberg U.S. Treasury Long Index is a universe of Treasury bonds, and used as a benchmark against the market for long-term maturity fixed-income securities. The Bloomberg U.S. Corporate High Yield Index measures the market of USD-denominated, non-investment-grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. The index excludes emerging markets debt. The Bloomberg Municipal Bond Index covers the USD-denominated long-term tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

The Consumer Price Index measures the average level of prices in the U.S. based on a basket of goods and services over a given time period.

It is not possible to invest directly in an index. Past performance is not indicative of future results. Different time periods may have different results. This material represents an assessment of the market environment as of a specific date; is subject to change; and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding the funds or any particular issuer/security.

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