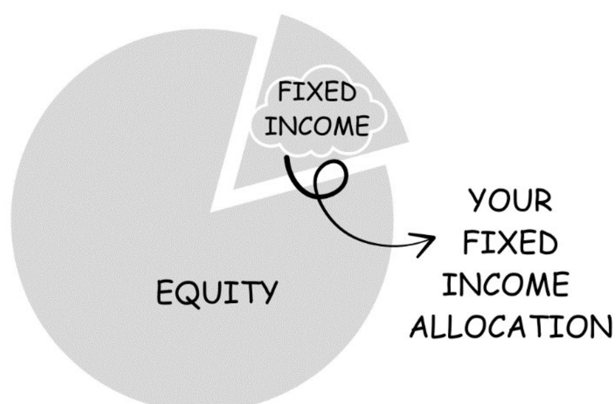
Moore Insights 101: Understanding Your Fixed Income Allocation

Should bonds and other fixed income assets be included in your portfolio? The answer to that will vary from person to person and depends on your overall investment goals. The better question might be if you understand what fixed income is and why it's used in an investment portfolio. If that is something you'd like to better understand you're in the right place. In the sections below we'll offer some clarity by reviewing what fixed income is, how it can be used in a portfolio, and how to build an allocation.

First, let's get comfortable with defining fixed income. Essentially, it's borrowing capital from a lender(s) with certain terms of how and when it is repaid. Let's think about this with a simple example, a home mortgage. Each mortgage has a borrowed amount (e.g., principal), an interest rate, and a repayment schedule. This is the basic profile of any fixed income security whether capital is borrowed by an individual, a corporation, or a government entity. In each case, the principal amount and interest rate depend on a borrower's ability to make repayment, also known as creditworthiness (think of your credit score). As an investment, fixed income can be traded in the market or held until maturity.



Common forms of fixed income are bonds and loans. Another security to consider in this asset class is preferred stock. Somewhat of a hybrid between equity and fixed income, preferred stock is ownership in an issuer (i.e., AT&T) with a dividend payment like fixed income. These investments do have a higher level of risk compared to other forms of fixed income but can provide investors with yet another option for building a fixed income portfolio.

This brings us to the question of why invest in fixed income? Typically, it's because we want to earn more interest than available through a bank while keeping our assets relatively safe. By investing in fixed income, we get the benefit of interest rates much higher than the typical savings account in exchange for the risk a borrower may not be able to repay their debt (e.g., default). The default risk, particularly for higher credit borrowers, is historically fairly low. If we think about fixed income compared to equity the risk of loss as well as fluctuations in value ("volatility") are both much lower. Of course, we don't get to have our cake and eat it too – the expected returns of fixed income investments have been much lower, accompanying less risk. Along with risk and return, keep in mind that because fixed income has different risk characteristics it is a nice diversifier to equity. Capital preservation and diversification are two important traits of fixed income investing. For many investors, the more impactful reason is the need or want to generate higher levels of income to meet their financial goals.

Now that we understand what fixed income is and why we'd add it to a portfolio let's go through some of the ways a fixed income allocation can be built. Just like other investments, there are funds and individual securities to choose from. Investors can choose an actively invested portfolio or can build a portfolio of bonds and other instruments that position them for achieving income goals. At **Moore Invested**, the latter option embodies our approach to fixed income.

Fixed income plays a foundational role in achieving investors' income goals. To position our clients on a path to achieving their goals we build the following allocations:

1. Investment in individual bonds: This is typically done by building what is referred to as a bond ladder: This is a series of bonds, each with a different term / maturity date. The "rungs" of the ladder are bonds with overlapping maturities and monthly or quarterly interest payments. Bonds will likely be held to maturity with

the principal typically recycled on a rolling basis. This serves as the core of the fixed income strategy delivering both income and capital preservation.

2. Investment in preferred stock: As a complement to the bond ladder, the fixed income allocation may also include preferred stock. These securities introduce a relatively higher level of risk but often have higher yields than the bond ladder while incorporating diversification. This will typically incorporate exposure to the utilities and financial sectors.

Hopefully, this brief explanation has answered some questions about fixed income investing and left you excited to get started. If you want to have a more in-depth discussion, please do reach out to us!

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