Quarterly Newsletter

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Time as a Commodity

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I have a complicated relationship with time. Over the past decade, as I have progressed in life from a single college student/young professional to a husband and now to a father (of two as of 2/2/2022!), the amount of time that I could consider “my own” has sharply decreased. However, with that decrease in time come many joys, some of which come from the sacrificing of one’s time for the sake of those you love.

Even so, I often find myself trying to “life-hack” my way to getting more out of the 24 hours that I have each day. And I’m not alone! There seem to be hundreds of books about speed reading (example title: Learn to Read a 200+ Page Book in 1 Hour) and how to become more productive. The way I most try to unlock time is to decrease the amount of sleep I get, but I thankfully have my wife to keep me in line and remind me how annoyed she gets when I keep snoozing my 5 am alarm clock to try to sneak in a couple more hours of “me-time” before work.

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A good friend recently recommended one of those “productivity” books that actually deems itself an “anti-productivity” book: Four Thousand Weeks – Time Management for Mortals. Instead of trying to squeeze out every drop of productivity in your awake hours, the book reminds us to understand and recognize the limitations/constraints of being human and learn to be okay with not having full control of your time:

> *“… the more you confront the facts of finitude instead – and work with them, rather than against them – the more productive, meaningful, and joyful life becomes. I don’t think the feeling of anxiety ever completely goes away; we’re even limited, apparently, in our capacity to embrace our limitations. But I’m aware of no other time management technique that’s half as effective as just facing the way things truly are.”*

By grasping the ways things truly are and setting my expectations for time appropriately, I can reduce the anxiety of not using my time wisely or seeking to accomplish the myriad of things I think I want to do.

Okay, now what does this have to do with investing? When we speak with clients about their investment portfolios, it is almost always their equity allocation that receives the bulk of the attention and discussion due to equities’ capability of being the growth engine of a portfolio. With growth potential, though, comes volatility, and with volatility comes eyeballs. Bonds/fixed income don’t usually provide the same level of “panache.” Over the past ten years, the S&P 500 has been over four times as volatile as the Bloomberg US Aggregate Index (the most recognized fixed income index) and has had almost four times as large of a drawdown. Each broad asset class plays a role in most of the client portfolios that we manage: on a high level, equities for growth and fixed income for income & stability. However, recent challenges in the fixed income market deserve some attention and discussion. Warning: there is math ahead! Skip down to the section “Specific Points” to avoid it.

A Deeper Dive

The first quarter of 2022 saw what some consider to be the worst quarter for U.S. bonds/fixed income in more than 40 years. With the recent uncomfortable amount of inflation still working its way through the financial system (and with fears becoming exacerbated by the energy/commodity impacts of Russia's invasion of Ukraine and the lingering impacts of the pandemic), yields on bonds shot up faster than most commentators and officials expected.

For example, the two-year Treasury rate started at 0.73% at the beginning of the year and ended the quarter at 2.28% - an increase of 1.55%. If you bought a two-year bond at face/par value from the U.S. government on 1/1/2022 for $1,000, you would have received semi-annual (twice a year) interest payments of about $3.65 for two years before getting your principal of $1,000 back at the end of the two-year term when the bond matured. A similar purchase at the end of the quarter on 3/31/2022 would have netted you interest payments of $10.14 semi-annually. On a high, high level (and assuming there is no risk of not getting your money back) which bond would you rather have – one that pays around $4 every six months or one that pays more than $10? It is easy to see that you would pick the latter – so would the market and therefore the former, lower-paying bond decreases in price.

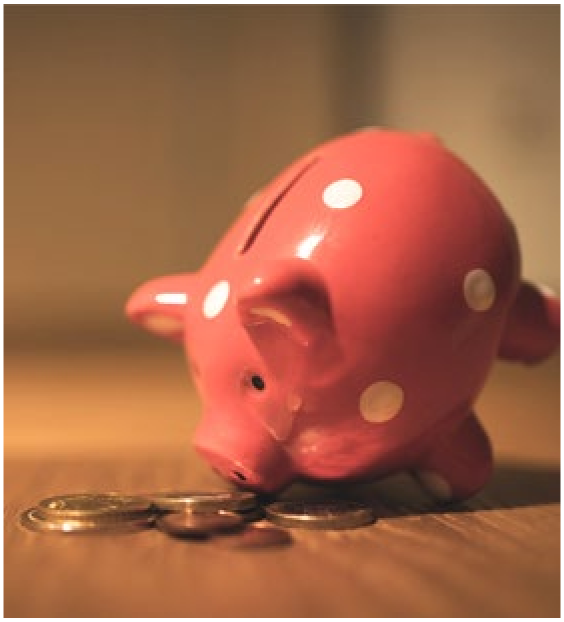
We have assumed that there is no credit risk (the risk that the issuer of the bond will not pay you), and therefore, in this example, you will still receive the $1,000 at the end of 2023 when your bond matures. So, what would your total annual return on the bond be from the date you bought it when it pays out at the end of 2023? The answer: 0.73% - the yield at which you purchased it. You let the bond issuer (here the U.S. government) borrow $1,000 on 1/1/2022, and you received four semi-annual payments of $3.65 plus your money back on 12/31/2023, totaling $1,014.60. That increase in nominal value of $14.60 divided by the initial purchase price of $1,000 and further divided by the two-year holding period is voila: 0.73% a year.

Specific Points

If you're not already asleep yet by the explanation above (or decided to skip!), I want to nail down a couple of specific points:

1. The beginning yield on a portfolio of bonds is the best guess we have for the annual return for that portfolio for the length of time that is equal to the duration of the portfolio. In other words, if the duration of a portfolio of bonds is four years, then we have a fairly good guess (assuming credit quality is strong in the portfolio) of the nominal returns that the portfolio will provide for the next four years. What the first quarter of 2022 proves is that in any period less than that duration period, the price can move up and down based on interest rate movements, which are incredibly hard to forecast.

   This connects to Four Thousand Weeks in that we should use the starting yield and the duration of a fixed income portfolio to set our expectations for our time invested in the bond market appropriately. Because we don't know what will happen with interest rates in the next quarter or two (avoid those who say they can with certainty), if you think you need funds from your portfolio in the very near future then we recommend avoiding duration/interest rate risk altogether and store those funds in cash or cash equivalents. Then, you won't have to worry about market movement on those funds. This is why we will always ask you about expected cash needs in the near future.



2. You may notice I used the term "nominal" a couple of times above. Nominal returns are the returns before considering inflation (with "real" returns being after inflation.) Fixed income should seldom be used as an investment response to inflation. We believe fixed income can be useful in a diversified investment portfolio due to the realistic expectations of returns for certain time periods as well as their tendency to be a "shock absorber" during periods where there is fear of deflation or decreasing prices due to an economic catastrophe (such as during the financial crisis and the initial months of the COVID pandemic.) For long-term inflation defense, equities are much more appropriate.

3. I have written a lot about bonds/fixed income above. Though there's not a true duration concept related to equities, it is not a bad idea to think about stocks as very long duration assets. Some sectors may be more sensitive to interest rate movements than others (energy, financials, and industrials, for example), but I think about equity duration not specifically about interest rates but instead about the randomness of near-term returns and the likelihood of positive returns. Since 1928, if you gave the S&P 500 a calendar year, it provided positive returns roughly 75% of the time. The longer you give it, the more likely your equity return was positive (with no 20-year periods so far providing negative nominal returns.) But in that almost 100-year history, the number and amounts of down quarters, years, and multi-year periods are not to be taken lightly.

When managing your investment portfolios, we consider both your short- and long-term cash needs as well as your ability to handle volatility in your diversified holdings. Time horizons are an incredibly important consideration when living through not-so-rosy periods of investment returns in some asset classes, such as fixed income this past quarter. Though interest rates have risen considerably in the past months, it is important to remember that bond markets are not broken. It is not fun seeing short-term declines in the value of your investments; some studies say that you feel twice as much emotion seeing declines (negative emotions) vs. increases in value (positive emotions). If anything, by thinking of the long-term (and potentially doing a little math!), we can set expectations appropriately for the time in which we hold our investments and even see the recent increase in interest rates as a buying opportunity.

Around The Office Updates

Looking Into Q2

Tax Time!

Once you have filed your 2021 return, we would appreciate receiving a copy (via email or by uploading to the Vault) to ensure we are as up to date as possible on your tax situations. Please reach out with any questions.

Jimmy and Sandi have been staying ever busy with Kaylee (4) and Maggie (2). Both girls have endless energy and love spending every waking hour singing princess songs while dressing up. And with our seasonally nice weather, they have all been soaking up as much outdoor-time as possible before the summer heat hits!

On February 2, 2022, Eric and Ellie welcomed their second son, Jonah Elwood Johnson, into the world! As you can tell, he is already flashing that big smile and melting hearts. Jonah's older brother, Abe, is incredibly pleased to have a younger brother and everyone has been adjusting very well.

Pete and Carla recently enjoyed a wonderful visit with Carla's brother in Park City, UT. They had a chance to eat delicious food, soak in the crisp mountain air, and enjoy some well-deserved relaxation time.

Stephanie's two grandchildren, Eli (7) and Georgia (5), are growing so fast. They are both staying highly active. Here is a picture of them getting geared up for the rodeo! Eli competed in the mutton-busting competition this year and did well! As of now, he has not indicated whether he plans to go pro 😉. Time will tell!