The Role of Fixed Income in Your Portfolio

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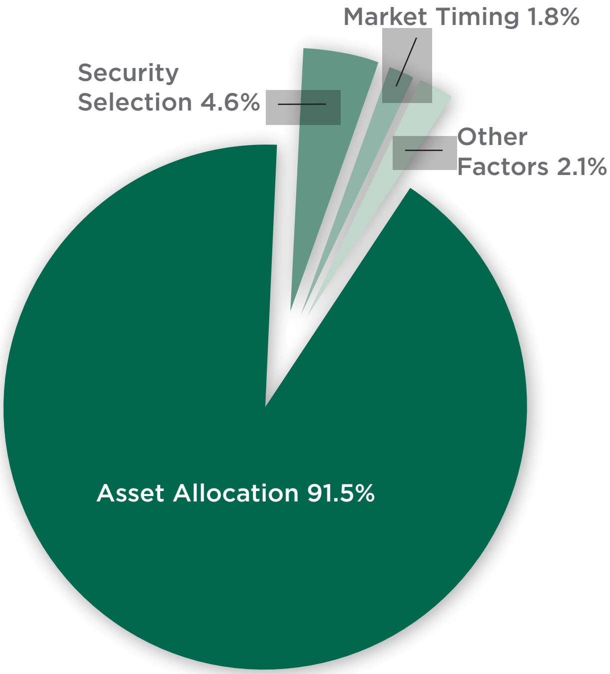
For the past several years, interest rates have been relatively low. As a result, bonds generate less income than they have historically, which may be less appealing to some investors. You may even want to get rid of your fixed-income investments altogether. But that would be a mistake because bonds still have an important role in your portfolio.

Despite Low Rates, Bonds Play an Important Role

Whether you own individual bonds, bond mutual funds, UITs or ETFs, as an asset class, bonds can provide diversification, income and stability to your overall investment portfolio. Bonds tend to move in different directions from stocks, so owning both can help smooth out your portfolio's overall performance. The right investment mix should be based on your specific financial goals, risk tolerance and time horizon.

Studies have shown that, over time, more than 90% of the variability of a portfolio's return is the result of the percentage of stocks, bonds and cash – also called your "asset allocation" – not the actual investments held. It's how much you have invested in each that primarily determines your portfolio's long-term performance.



Source: "Determinants of Portfolio Performance II: An Update," Gary P. Brinson, Brian D. Singer and Gilbert L. Beebower, *Financial Analysts Journal*, 1991.

Past performance is not a guarantee of future results. Diversification does not guarantee a profit or protect against loss.

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Expect Rates to Remain Volatile

Lower inflation, slower economic growth and expectations for cuts in short-term interest rates by the U.S. Federal Reserve (Fed) has driven interest rates lower. The drop in interest rates and rise in bond values also caused more volatility in the bond market.

For investors who need to add fixed-income investments, lower interest rates mean lower current income. But for investors who already own a significant amount of fixed income, the falling rates and rising bond values may mean higher overall portfolio value. And because bonds tend to trade less frequently than stocks, we may see exaggerated price fluctuations over a short period of time. Don't be surprised by bouncing interest rates and bond values, and remember that long-term bond values generally flucuate more than short- and intermediate-term bond values.

Properly Laddered Portfolios May Help Reduce Volatility

One way to help reduce volatility is by owning bonds with different maturity dates. We are currently cautious about long-term bonds and recommend they make up no more than 25% of your fixed-income portfolio. With interest rates still relatively low, we believe they will move higher over time but could remain volatile in the near term. Rising interest rates hurt the value of all bonds but typically affect long-term bonds the most. If you are overweight in long-term bonds, consider reallocating to our recommended bond ladder to help reduce the impact that rising interest rates can have on your portfolio.

Bond Ladder Recommendations

Maturity Type	Recommended Range
Short-term (up to 5 years)	30%–40%
Intermediate-term (6 to 15 years)	40%–50%
Long-term (16+ years)	15%–25%

Actions for Investors

1. Maintain a long-term perspective. Most financial goals, like saving for or living comfortably in retirement, are long term, so don't let short-term changes in bond values derail your long-term plans. Although some investors are tempted to jump into and out of the market as interest rates and bond prices change, we believe you should buy bonds for the diversification, income and stability they provide.

2. Revisit your target investment mix. Meet with your financial advisor regularly to ensure that your investment mix is in balance. Your risk tolerance, time horizon and financial goals will help you determine what your asset allocation should be. And since your asset allocation may be responsible for the bulk of your portfolio's long-term return, keeping in line with your target is especially important. We believe that regardless of the level of interest rates, bonds are a critical component of any good investment mix.

3. Properly ladder your fixed-income investments. Reduce any overweight positions, particularly in long-term bonds since they will be affected the most as interest rates change. We recommend having no more than 25% of your fixed-income portfolio in long-term bonds.

While interest rates are relatively low, bonds play an important role in your overall investment portfolio. Talk to your Edward Jones financial advisor to make sure fixed income is part of your target investment mix.

Before investing in bonds, you should understand the risks involved, including credit risk and market risk. Bond investments are also subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease, and the investor can lose principal value if the investment is sold prior to maturity.

Investors must evaluate whether a bond ladder and the securities held within it are consistent with your investment objectives, risk tolerance and financial circumstances.

