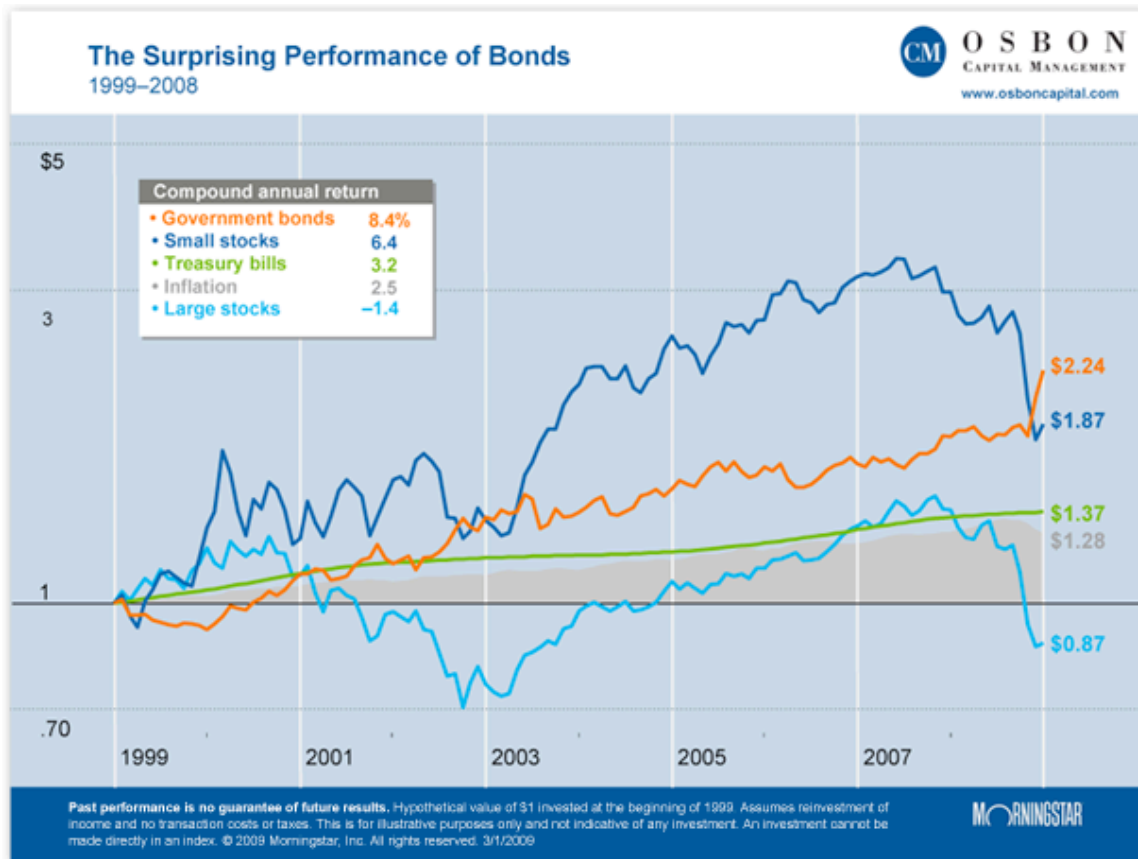




Quick Q & A #15

Q: Is the party over for fixed income investments?



A: Maybe, but don't overreact.

The last decade has been a sobering object lesson in the unpredictability of capital markets. We can't recall anyone predicting in 1999 that government bonds would outperform both large and small stocks over the next ten years, but the chart above shows that's exactly what happened. In fact, bonds beat large stocks by almost 10 percent a year compounded.

But now, with interest rates so low, many investors are wondering whether it's game over for bonds. Is it time to bail out on bonds altogether? The only honest answer we can provide is that we don't know. It is simply not



possible to predict what bonds will do in coming months and years, nor how that performance will stack up against other asset classes.

However, we do know this: after an uninterrupted 30 year bull market in bonds and with interest rates at historic lows, there's less and less room for further price appreciation in bonds. Bonds rise in value when interest rates fall, with an obvious downward limit for rates at zero percent. On the other hand, there's no limit on how high rates can go.

If interest rates rise, bond values fall

Unless you believe the US will catch sustained Japan-style deflation, there just isn't much room for lower rates and higher bond prices. But an increase in interest rates – surely possible as the economy improves – could take a big bite out of bond values. For instance, a one percent increase in the current 10-year Treasury rate of 3.75% would produce a total return of negative 11.38% (Bloomberg). A one and one half percentage point increase produces a negative 18.44% return, a catastrophic loss for risk-averse investors seeking capital preservation. Note that the 10-year Treasury was at that 5.25% level as recently as May 2007, before all the trouble began.

We are careful not to predict what markets will do. But we sense that risk is getting out of balance for bonds – lots of downside and very little room on the upside.

With this risk imbalance in mind, we are making reductions in bond allocations – especially at the long of the maturity ladder – in client portfolios that hold fixed income assets. We're also making small increases in TIPs, WIPs, and global equities. As always, highest quality is the rule of the day, with almost all our bonds government guaranteed.

We believe these changes are a prudent way to realign risk and return until interest rates move back to more normal ranges.

Read more: [More Quick Q&As from Osbon Capital Management](#)

Next time: How long will that nest egg last?



Contact: John Osbon 617-217-2772 josbon@osboncapital.com

Visit: www.osboncapital.com

Osbon Capital Management, LLC ("Osbon") is an SEC registered investment adviser with its principal place of business in the Commonwealth of Massachusetts. Osbon and its representatives are in compliance with the current notice filing requirements imposed upon registered investment advisers by those states in which Osbon maintains clients.

Small stocks in this example are represented by the Dimensional Fund Advisors, Inc. (DFA) U.S. Micro Cap Portfolio. Large stocks are represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. Government bonds are represented by the 20-year U.S. government bond, Treasury bills by the 30-day U.S. Treasury bill, and inflation by the Consumer Price Index. Underlying data is from the Stocks, Bonds, Bills, and Inflation® (SBBBI®) Yearbook, by Roger G. Ibbotson and Rex Sinquefeld, updated annually. An investment cannot be made directly in an index.

Any historical returns are not net of advisory and/or other fees and expenses. Past performance is no guarantee of future results. There is no guarantee that the views and opinions expressed in this Q&A will come to pass. Investing in the stock market involves gains and losses and may not be suitable for all investors. Information presented herein is subject to change without notice and should not be considered as a solicitation to buy or sell any security.

For additional information about Osbon, including fees and services, send for our disclosure statement as set forth on Form ADV using the contact information herein. Please read the disclosure statement carefully before you invest or send money. For information pertaining to the registration status of Osbon, please contact Osbon or refer to the Investment Adviser Public Disclosure web site (www.adviserinfo.sec.gov).