Bedrock
Investment Advisors

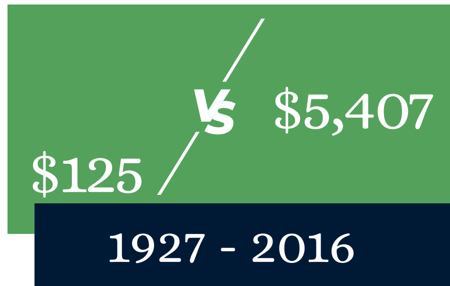
SHOULD YOU CHOOSE SAFER INVESTMENTS OVER STOCKS?

The answer seems clear. Investments in stocks are appealing because, over the long term, they can grow exponentially and typically outperform bonds and similar investments. But there is always the potential for extreme losses. On the other hand, bonds are not nearly as risky because they have predictable terms that protect investors from significant losses.

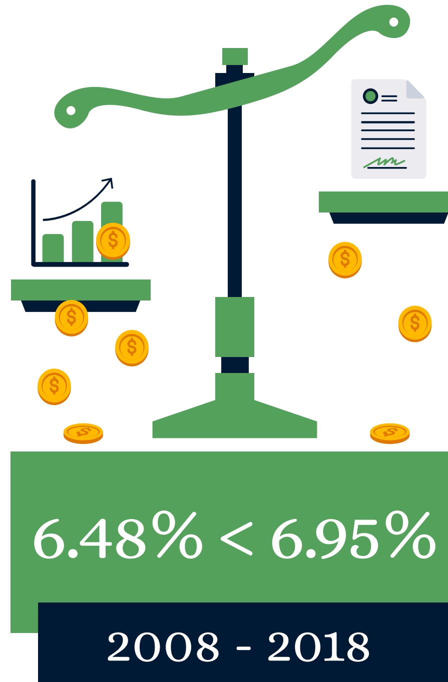
Conventional wisdom – and the financial industry's standard – has told us we should invest in stocks when we are young and can still weather potential market downturns. Then, when we get closer to retirement, we should reduce our portfolio risk and move our allocations away from stocks and into less volatile investments.

Over a more extended period, it seems stocks are vastly superior to investments like bonds. However, one must be prepared for the significant amount of risk that stocks can bring – something that grows less tolerable as we approach retirement. That's why it might make sense to reduce our exposure to stocks and move our assets to more stable investments like bonds.

ARE BONDS THE WAY TO GO? CONSIDER THIS.



From 1927 to 2016, one dollar invested into different investment options – large-cap stocks, long-term bonds, and U.S. Treasury bills – produced varied results. According to the 2017 SBBI Yearbook by Roger G. Ibbotson, Duff, and Phelps, the dollar invested in bonds was only worth an estimated $125. The stocks, on the other hand, ballooned to a total of $5,407.



6.48% < 6.95%

2008 - 2018

From 2008 through 2018, bonds produced a 6.48% return, as compared to 6.95% for large-cap stocks in that same period. However, with interest rates at historically low levels, bonds will not likely produce this type of return for the next ten years.

As of December 2020, the 10-Year Treasury Yield was a paltry 0.92%. For bonds to generate the same amount of capital gains – through the increase in bond prices – and create a yield above 6%, the yields would have to decline significantly from this already depressed level over the next ten years. The more likely scenario is that bond yields will revert to a more normal level, causing bond prices to decline, possibly creating losses in what is traditionally the safe portion of an investment portfolio.

FIXED INDEXED ANNUITIES: THE BEST OF BOTH WORLDS.

But there is another option. Fixed Indexed Annuities provide a degree of safety while allowing for growth potential that could significantly exceed other options. Fixed Indexed Annuities don't rely entirely on the stock market. Instead, they feature a two-phased approach - a guaranteed return from an insurance company, plus a market-based return tied to a stock market index such as the S&P 500.

Here's how it works: Insurance companies take advantage of the pooled risk that comes with having a large volume of policyholders instead of just an individual one, allowing them to create a customized risk/reward profile that matches particular needs. Since the policies are connected to an index, they have a "floor" and typically a participation rate that enables your investment to grow tax deferred. What this means, put simply, is that you can benefit from an upswing in the market, with an amount of downside protection in the form of a minimum guaranteed return. The result is a greater potential upside than a traditional fixed contract, with less risk than a variable annuity.

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SOURCES:

Daily Treasury Yield Curve Rates
2017 SBBI Yearbook by Roger G. Ibbotson, Duff, and Phelps

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