SCARSDALE Investment Group

The Unbeaten Path to Secure Investment Growth

The Return of the All-Bond Portfolio

Stan Richelson and Hildy Richelson, January 2024

When the market goes up, risk tolerance is infinite, but when it goes down risk tolerance is often at zero

--Harold R. Evensky

When we started out as new investors, we were advised by the media, investment books and all investment professionals of two ideas:

Diversify your investments to maximize returns; and

Stocks will always outperform bonds.

This article makes the case that "it ain't necessarily so" particularly at all times and in all markets. Come along with us as we explore another view of the investing world for individual investors.

How We Began Our Investment Career

Let's start at the beginning with our experience as thirty-year-old newbie investors. We decided to invest all of our funds in the five most aggressive no-load stock funds with the following guard rails: If we thought the stock market would go up, we would invest all our funds in the 5 no-load stock funds. If we though the market would go down, we would redeem the 5 funds. If we thought the stock market would go up, but it actually went down by more than 10%, we would sell all the funds.

What could go wrong with that strategy? At the end of three years, we added up all the gains and losses and determined that we almost broke even. We concluded that this was a difficult path to a secure retirement.

The All-Bond Portfolio

We then considered another strategy: We knew that there were two main investments open to individual investors: stocks and bonds. What if we were to invest all of our funds in bonds, instead of stocks? And so was born the Strategy of the All-Bond Portfolio. This strategy is laid out in great detail in our book entitled: **Bonds***: The Unbeaten Path to Secure Investment Growth*, 2nd ed. John Wiley & Sons.

But why consider the All-Bond Portfolio now? We believe that the markets have currently shifted enough to challenge the truism that stocks will always outperform bonds. Stocks have enjoyed a 15-year major bull market since the crash of 2008 and recovery. Interest rates were forced to zero by the Fed (and sometimes negative). However, inflation forced the Fed to dramatically increase interest rates over the last two years. With these major shifts in the economy and markets, we believe it is time to reexamine the advantages of the All-Bond Portfolio and determine whether you might invest some or all of your funds in a portfolio composed of individual bonds.

Advantages of the All-Bond Portfolio

When the rate of return on investments is calculated, these categories of expenses are generally ignored:

- Taxes
- Fees and transaction costs
- Bad timing

And the biggest factor of all, which is ignored, is to RISK ADJUST when you are comparing stocks and bonds. The brokerage houses would have you view stocks and bonds in the same way – by daily, monthly and annual gains and losses. Why? Because you are more apt to trade. Moving money makes money for salesman.

However, individual bonds are different. The brokers call them a ‘dead money’ because you could hold your bonds for ten-years or more. No transaction fees for them!

Though the value of a bond may fluctuate similar to stocks, **individual bonds come due** at their face value. As a bond approaches its due date, the value comes closer to par – the face value of the bond – since it is no longer affected by market movements and pricing. That is a huge difference between stocks and bonds, which is masked if you own bonds through bond funds or ETFs because funds never come due. They must liquidate their portfolios.

<u>The Scarsdale Strategy</u>

Let’s compare the Scarsdale Strategy that we developed to provide an example of the All-Bond Portfolio:

If you invest in a portfolio of tax-exempt municipal bonds, the income is generally federally tax-free, and if in a retirement account -- tax-deferred.

The Scarsdale Strategy is to buy and hold a portfolio of the highest quality bonds until the bonds are called or come due, thus minimizing fees and transaction costs. There is also no bad timing since you will receive the face value of the bonds when they are called or come due.

The underlying concept of the Strategy is to match and align your bond portfolio with your financial needs and life goals (for example, retirement and education expenses), rather than speculate in stock and other risk assets.

And don’t forget to risk adjust your investment returns. We begin our analysis with bonds rated AAA or one notch down. The historical risk associated with these bonds is extremely small.

<u>Conclusion</u>

A unique aspect of the Scarsdale Strategy is that it is based on CASH FLOW from a portfolio of bonds. We do not take into account the yearly gains and losses from the portfolio because we will hold the bonds until they are called or come due and at that time the principal of the bond will be repaid.

If you wish to determine whether the Scarsdale Strategy for a part of your portfolio or the All-Bond Portfolio makes sense for your financial situation, call us.