A Short Commentary: The Current Risks of Stocks and Bonds

By Hildy Richelson and Stan Richelson, March 9, 2024

This will not be a learned article dealing with the evaluation of the risks in the stock and bond market. This will be a snap shot of some of our reflections as we think about a few aspects of what we see in the news today.

Are Stocks Riskier Than Usual at the Present Level?

According to *The Economist*,[i] the corporate world is about to face an almighty test. Quoting:

- Michael Smolyansky of the Federal Reserve ("the end of an era" and "significantly lower profit growth and stock returns in the future"),
- Goldman Sachs, a bank ("Tailwinds of the last 30 years are unlikely to provide much boost in the coming years." and
- Jordan Brooks of AQR Capital Management, a quantitative hedge fund, ("a repeat of the past decade's equity market performance would require a heroic set of assumptions").

These financial gurus see the strong corporate performance as a "mirage." The overall reasons are that since 2010 business has benefited from two events: a decline in both corporate interest rates and corporate taxes. This has enabled corporations to show record profits, though taking those factors into account, "underlying profits have grown less impressively."[ii]

Should You Consider Bonds?

Bonds are ignored by the financial press - except when they decline in price. There is no mention that if bonds drop in price that means that yields have gone up and bonds are now more attractive for buyers. In 2022 when stocks and bonds both declined substantially, this created a major buying opportunity for bonds which still exists today. If stocks decline in price, the media reports a buying opportunity.

Are All Stocks a Suitable Buy for All Investors?

Here is an interesting news item that sheds light on risk. The stock market slump in 2022 led to a 213% uptick in Errors and Omissions Insurance claim payouts from insurer Golsan Scruggs on its Registered Investor

Advisor policies in 2023. The surge was driven by a **500% increase** in claims over suitability, as clients complained that their advisors put their money in investments that weren't appropriate for their portfolios.[iii]

If You Believe Stocks Are a Good Buy at This Level, Should You Leverage Up?

We see a headline that "Teenagers are Pouring into Stock Investing."[iv] Another article suggests that young people should borrow to purchase stocks and 100% allocation to stocks is not too much.[v] Afterall, they have the most to gain long-term and the least to invest. People lever up to buy a house. Why not do the same for stocks?

These statements do not take into account the level of risk entailed with borrowing to purchase stocks. There is a famous Andrew Carnegie quote that when the shoe shine boys talked stocks, it was a sell sign in 1929. Is teenage borrowing for stock purchases in the same category in 2024?

Looking at Japan's stock record might give the exuberant stock investor pause. The Nikkei Stock Average closed at a record high in 1989. Then the market crashed in 1990. It has taken 34 years, to 2024 to reach that level again. Not all stocks have rebounded. There was no interest among investors "to play the market."[vi] Instead, investors bought bonds.

Alts

The hot new investments for individual investors are Alts, including private equity and private debt. These investments, which were previously available only for institutions and the very rich, are stocks and bonds that are not traded in a public market with current price disclosure. Recent articles have highlighted that, while private equity and private debt may be good investments, the current value of their assets are currently quite opaque and may be illiquid. Also, due to opacity, valuations are potentially unreliable.

Sequence-of-Return Risk for Retirees who Hold Equities

If you are planning retirement in the near future, what happens to your stock portfolio when your earned income ends may determine whether you will have a successful retirement. If there is a significant decline in the stock market when you are now fully depended on your stock portfolio, your financial plan may not succeed. If the market drops soon after your retirement and there is no indication that it will recover any time soon, you will need to take a withdrawal from your investments to support yourself. If you take what you originally planned, you will now be taking a much larger percentage of your assets.

Our Pitch for Bonds

Depending upon your time period, outperformance of bonds can and did happen. Edward McQuarrie if Santa Clara University looks at data from the 1792 to and 1941, and found that stocks did not consistently outperform bonds.[vii]

Our strategy around bonds does not rely on bonds appreciating in value. Our strategy relies on CASH FLOW. High quality bonds pay a predictable and fixed rate of return. You will know how many dollars of interest income will be paid to you each year. You hold the bonds until they are called or come due. They come due at their face value. The only risk is a bond default. You can build a predictable cash flow with bonds.

If you had invested in bonds, you would know what you have and could plan accordingly. It might not be what you want, but at least you would know what you have.

You will not suffer a sequence-of-return risk with bonds.

A Final Thought

One prospective client invests in real estate. He has to deal with tenants, property depreciation, repairs. He said he bought a Microsoft bond. He said: “Imagine if I had Microsoft as a tenant, playing regularly. How happy I would be.” That is what you have when you purchase high-quality bonds. Great tenants that don’t clog up the toilet.

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[i] “Problems on the Horizon,” *The Economist,* March 2nd, 2024, pp. 61

[ii] “Problems on the Horizon,” p. 62.

Authors of **BONDS: The Unbeaten Path to Secure Investment Growth**, 2nd Ed. John Wiley 2011.

[iii]Christoper C. Williams. "E&O Insurer Saw 213% Rise in RIA Policy Payouts Last Year," *Financial Advisor Magazine,* March 4, 2024.

[iv] Hannah Miao and Ann Gunjan Banerji. "Teenagers are Pouring into Stock Investing," *The Wall Street Journal*, February 20,2024.

[v] "The 100% Strategy," *The Economis*t, February 24, 2024.

[vi] Miho Inada. Japanese Broker Waited 34 Years for a Stock Boom," *The Wall Street Journal*, February 20, 2024.

[vii] "The 100% Strategy," p.64.

Authors of **BONDS: The Unbeaten Path to Secure Investment Growth**, 2nd Ed. John Wiley 2011.