COMPASS WATCH

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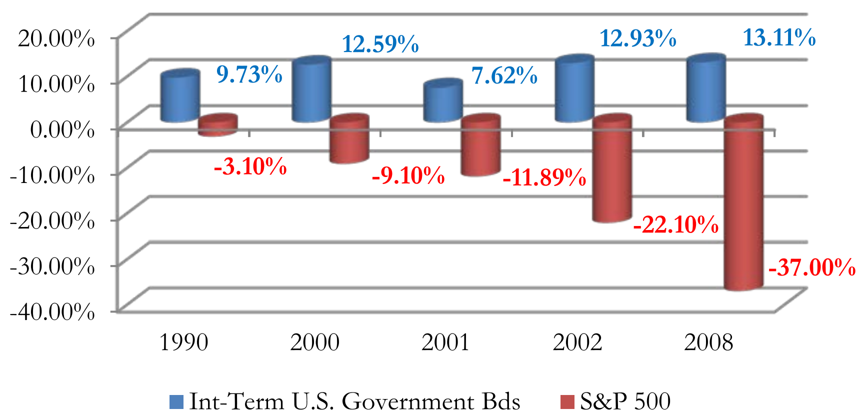
NAVIGATING THE FIXED INCOME LANDSCAPE: STAYING THE COURSE

As the equity markets continue to reach new highs (positive 200%[1] from 2009 lows) and the current yield on the 10-year U.S. Treasury hovering around 2.35%[1], a number of highly-regarded publications have implied that stocks continue to be the only reasonable place to invest. The current thinking is "why invest in bonds when yields are at historic lows (capping a 30-year secular decline in interest rates from 15% to 1.5% along with Fed policy expectations toward tighter and higher interest rates)?" As we scan across the capital markets, it appears to us investors either have lessened their concerns or have become complacent about valuations. The next real opportunity in fixed income is maintaining a position of patience and flexibility—"dry powder" for the next downturn. Ultimately as long-term investors, you want to participate, not speculate.

Given the current equity bull market, it might be useful to review how high-quality, intermediate-term bonds performed when the equity markets turned acrimonious. As shown below, since Compass' inception, the S&P 500 Index has had *five* years of negative returns, while intermediate-term bonds provided *five* years of positive returns.

TOTAL RETURN[2]



However, not all bonds are created equal. Many investors today are also being tempted into higher-risk bond substitutes (high yield, emerging markets, MLPs or REITs) by higher nominal yields. Less understood however, are the drawbacks (extended maturities, lower credit quality, opaque or illiquid investments, for example). Often your financial successes come not from what you invested in, but by what you have avoided.

Since 1988, we have constructed our bond portfolios by equally-weighting our maturities 1-10 years. Why do we "ladder" our bond portfolios? To mitigate risk and control volatility within the portfolio. The primary goal of a laddered bond portfolio is to achieve a total return over various interest rate cycles to that of a longer-term bond, but with less market risk. At Compass, we invest in high-quality, intermediate-term bonds only in our portfolios rather than lowering quality and lengthening maturities. Additional virtues of our laddered bond investment style include: 1) Having a fixed maturity date; 2) Generating a predictable level of income; and 3) Owning marketable (liquid) bonds.

Long-term, successful investing is seldom easy. Maintaining sensible investment disciplines and resisting the temptation to "do something" might just allow you to preserve your wealth and be rewarded with more consistent and reliable returns.

[1] As of November 13, 2014.
[2] 2014 Ibbotson SBBI Classic Year-book.

For more information regarding our company, disciplines and results; please call, write, e-mail or visit our website: www.compasscap.com

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