WHY RISING INTEREST RATES HELP COMPASS'S BOND STRATEGY

One of the first lessons taught to every aspiring financial services professional is "when interest rates rise, bond prices decline." So far in 2022, we have seen this happen rapidly. The Federal Reserve has already raised short-term interest rates to 2.25% this year, up from almost 0% at the beginning of the year. More importantly for bond portfolios, the yield on the 10-year U.S. Treasury Bond has risen to 2.65% as of July 31st, up significantly from 1.51% on December 31st. As a result, bond prices have fallen 5.25% year-to-date through July 31st, as measured by the Bloomberg U.S. Intermediate Government/Credit Bond Index.

Given this information, it would be logical to assume that bond investors are worse off now than they were at the beginning of the year, and in some cases that is true. Investors that hold bond mutual funds, or employ other fixed-income trading strategies where maturities are not defined, are more likely to be worse off. However, if you own a high-quality bond ladder, that isn't the case. Not only will your portfolio have the same ending value when your bonds mature that you anticipated at the time of purchase, but future investments will now be made at higher yields!

Bonds that are held in a high-quality bond ladder are not immune from the general rule that as rates rise, the prices of existing bonds fall. However, there is an important difference between daily bond price changes and the long-term outcome an investor achieves over the life of an individual bond held to maturity. Bond investors should choose bonds as part of their portfolio with the goals of preserving capital, liquidity, and providing predictable cash flows. Rising rates during the life of an individual bond do not impact the ability of an investor in a high-quality bond ladder to meet these goals.

For an example, let's look at an investor who purchases a $100,000 U.S. Treasury bond with a 5% coupon that matures in 1 year. This bond will provide the investor with $105,000 at maturity in 1 year. This value is comprised of the $100,000 return of principal and $5,000 in interest payments. If interest rates were to immediately rise by 5% after purchasing this bond (an extreme example for illustrative purposes), the value of the $100,000 bond would be expected to drop to roughly $95,000. If the opposite were to happen and interest rates fell by 5%, the value of the bond would be expected to increase to roughly $105,000. Regardless of which way interest rates move in the short term, the investor can expect to receive $105,000 at maturity in 1 year.

If the investor needed that $105,000 to fund their life in retirement, make improvements to their home, or make a college tuition payment, these goals will be achieved as planned, regardless of what happens to interest rates over the life of the bond. However, if instead of a bond ladder, the investor owned bond mutual funds or other fixed-income trading strategies, they would not have the same peace of mind. This is because bond funds hold a variety of bonds of differing maturities and credit quality. When the investor needs that $105,000, the price of the fund will reflect the price of bonds at that time. As a result, the bond fund investor could realize a loss of principal that they were not expecting at the time they purchased the bond fund.

Another advantage of owning a high-quality bond ladder in an environment with rising interest rates is that as bonds mature, the proceeds of bond maturities are re-invested at the higher prevailing interest rates. In Compass's bond ladder strategy, bond maturities are staggered each year so that investors are positioned to take advantage of increasing yields over time.

Conventional wisdom is that bond investors fare poorly in rising-interest-rate environments. The Compass fixed income strategy of building high-quality bond ladders helps our clients meet their goals, regardless of the interest rate environment. This approach serves a critical role in balanced portfolios. We would welcome a conversation about how these strategies can help you meet your goals.

FIRM

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AUM

$2.0 billion

INCEPTION

1988

COMPASS PHILOSOPHY

As an independently-owned firm, Compass provides customized investment services to individuals, foundations/endowments, trusts, and retirement plans. Our objective is to preserve and enhance the real purchasing power of our clients' wealth over time.

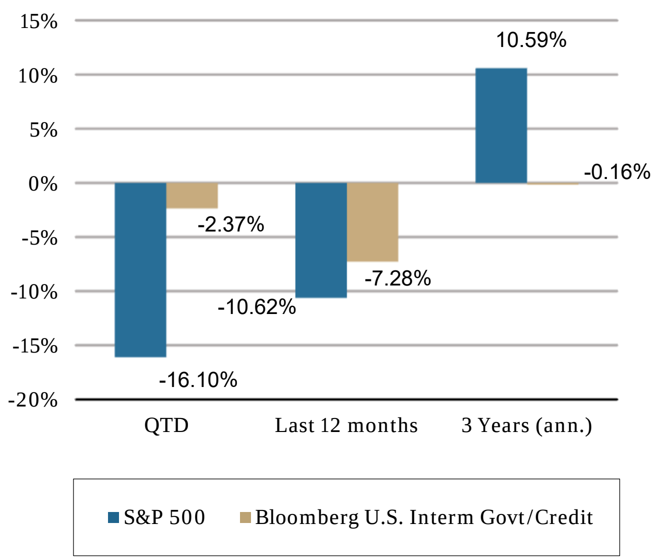
Our clients value working directly with a seasoned and experienced team of portfolio managers to help them navigate their investments relating to:

-Building a quality portfolio	-Divorce
-Retirement	-Inheritance
-Sale of a business	-Trust distribution

Our experienced team is always available to provide financial advice and review your financial assets.

MARKET INDICES

Total Return as of 6/30/2022



For more information regarding our company or results, please contact us at investors@compasscap.com.

COMPASS CAPITAL MANAGEMENT

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