INVESTOR'S EDGE

How to adjust to the current tough markets

Take a look at your bond allocations and investigate high dividend stocks.

"Be curious. Not judgmental." — Walt Whitman

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It's been a tough start to the year, boys and girls.

As I write this, the S&P 500 Index is down around 15% year to date and has flirted with entering a bear market — defined as a decline of over 20% — several times over the past month.

For most of my 30-year career, a 60/40 stock-to-bond portfolio was viewed as a relatively safe allocation for retirees, moderate risk investors, and even large pension/endowment funds.

Personally, I have always felt this was a bit too conservative. Healthier returns would be generated for families by taking a more equity-centric focus, while being aware of your income and retirement spending needs, of course.

The fact is, in this volatile stock market, bonds have not done you any favors. The Vanguard Total Bond Index is down around 10% at the time of this writing, while treasury bonds, supposedly the safest of all investments, are down 15%.

Everyone knows that inflation has picked up markedly over the past year, increasing to levels we have not seen in 40 years. We also know that the Federal Reserve has recently been raising interest rates after almost 13 years of keeping them near historic lows.

Remember, if interest rates and inflation continue to move higher, your bonds are going to decline. Period.

Many of today's investors do not know of or even remember that bonds had terrible bear markets in the 1960s and 70s, in a period very similar to what we have today.

So, what should a prudent investor do in this new economic environment, and does the traditional 60/40 portfolio need to be re-evaluated?

Here are my thoughts:

Your bonds: I am not, by any means, suggesting that investors sell all of their bonds. I do, however, recommend taking a closer look at your bond allocation and adjust some of your exposure to areas that are less sensitive to interest rate changes and inflationary pressures.

The i-Shares 1-5 Year Corporate Bond ETF (Symbol: IGSB) is a short-term investment grade bond fund that has significantly outperformed the total bond index over the last year. It provides diversified, low-cost exposure to short-term U.S. corporate bonds that is less sensitive to rate hikes and therefore carries less interest rate risk.

Also, the Vanguard High Yield Fund (Symbol: VWEHX) invests in high-yield corporate bonds. While more volatile than treasuries or short-term bonds, high-yield bonds are also generally more insulated from inflation and rate hikes and offer the benefits of both higher yield and some capital appreciation.

Your dividends: With cash losing some 7%+ to inflation, cash is unlikely

to be a good place to leave your investments. At the same time, the stock market is likely to remain volatile.

A good hedge is owning high-quality, dividend-paying stocks. These types of companies generally hold up better during market declines and pay dividend yields that help offset inflation.

The Vanguard High Dividend Yield ETF (VYM) is a fund I have recommended previously and is comprised of U.S.-based stocks with high-dividend yields including Chevron, JP Morgan, and Coca-Cola. The fund is holding up much better than the market as a whole and is a solid investment for both income and protection from volatile markets.

The Vanguard International High Dividend Yield ETF (VYMI) is comprised of international stocks with high-dividend yields including Toyota, Shell, and Novartis. Yielding an enticing 4.7%, VYMI offers both significant dividend income and also international diversification which is an area that may begin to outperform in this changing market environment.

Your Alternatives: Real and alternative asset classes including real estate, commodities, energy, etc. generally do very well during periods of inflation and rising interest rates.

My favorite energy stock over the years has been Chevron (Symbol: CVX), which yields over 3% and I believe is both a long-term buy and hold stock and great inflation hedge.

For the riskier investor, the Vanguard Commodity Strategy Fund (Symbol: VCMDX) could provide great upside potential if inflation continues to increase. However, I would keep this only to a modest (5% or less) position in your portfolio at this time.

No one knows how long this bout of inflation will last or even when it will peak. However, local investors may want to rethink the traditional 60/40 portfolio which has long been used as a model for many retirees. I believe the aforementioned investments will provide better long-term upside potential against cost of living increases.

As Oliver Wendell Holmes said, "Prophesy as much as you like, but always hedge."

Jim Burns, a chartered financial analyst, is president of J.W. Burns & Co. The opinions expressed here are his and do not necessarily reflect those of The Post-Standard. Readers should do research before deciding on an investment. Contact him at jburns@jwburns.com

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