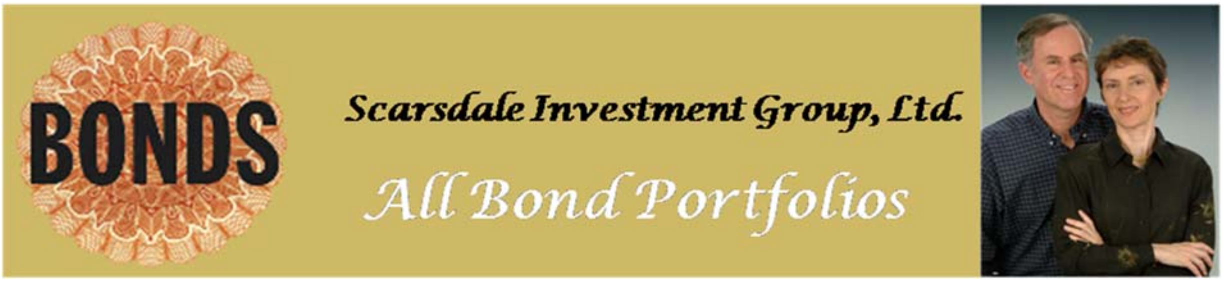


**I Just Lost Money in Bonds**

*Hildy Richelson and Stan Richelson*
*Scarsdale Newsletter, March 24, 2022*

Bob, one of our most sophisticated clients sent us an email this week. In it was, we think, a "complaint", disguised as an inquiry:

> We have lost more than $500,000 in the value of our (individual) bond account since December, 2021. (Emphasis added) I know we are supposed to stay focused on the income, but it is a little hard to watch.

Bob faces a quandary: He wished for, hoped for higher interest rates, and now he is getting what he wants. But hey! His bond portfolio took a paper loss of $500,000. That is the cost of getting what he wants!

A recognized loss is a loss you experience after you sell. A paper loss shows what would happen if you decided to sell.

Bob, of course knows that the basis of the Scarsdale Investment Group strategy is the creation of tax-free cash flow from high-quality individual bonds. The bonds are held until the earlier of maturity or the date that they are called. He knows that we do not trade unless the client makes a request. This strategy minimizes taxes, fees and exposure to bad timing.

Bob is really not complaining since he concludes that:

> I am not looking for any kind of solution to things that aren't really in your control…just working on mental preparedness, here.

As we said, Bob knows that even sophisticated clients who hold bonds can take a mental beating at times. He knows that he himself hates losses as much as the next guy, but income averaging is a tool that demands you hold your position and not panic.

Bob is correct that the stated value of his account did decline by $500,000, and paper losses stink! Nobody likes to see them. That is precisely why the brokerage statements clearly show the losses. It might spur you to trade – making money for the brokers.

Here is how we responded to Bob's great email:

Your inquiry and request over the past two years focused on your discomfort with the low interest rates available on the highest quality tax-free bonds. You asked: When will the interest rates increase? Not being a seer, we didn't have a response.

We told him: Your wishes have recently been answered, since the yield on high-quality tax-free bonds had increased by about 50 basis points (this is one-half of one percent). Since you have a $10 million portfolio invested in bonds and the interest rates (yield) has gone up by .5% (50 basis points), the paper value of your portfolio has decline by $500,000.

We asked: How does this impact you, Bob?

You have not "lost" any money because of the following:

- The coupon of your bonds has not changed, so the annual cash flow is the same.
- Your yield-to-maturity, yield-to-call and current yield (coupon/price) have not changed. You are receiving exactly what you were promised at the date of purchase.
- You are not a trader. You follow a buy and hold philosophy, meaning that you don't sell if the value of your bonds rises or falls. You only recognize loses or gains if you trade – paying the fees and taxes.
- In fact, if you follow the Scarsdale strategy, rising interest rates provides you with the upside opportunity.

Yes! Rising interest rates are the upside case with the Scarsdale strategy. We are always hoping for the value of your portfolio to decline because the reason for the decline is the *increase* in interest rates. All our clients who invest in bonds want the interest rates to rise, so we can reinvest at the higher rates. Nobody wants the value of their portfolio to decline. But as the song says: You can't have one without the other.

Investment in higher interest rate bonds will grow your cash flow, which is the basis of the Scarsdale strategy.

Retired, or planning your retirement? The key is cash flow. You can't predict or plan your lifestyle based on projected gains and losses. You can plan a budget on predictable cash flow.

Bob said that he already knew all this, but the fall in value of his portfolio created a dis-ease. However, focusing on his goal of a predictable cash flow did help with his “mental preparedness,” and he repeated: “I am not really complaining.”

We concluded with the old saw that in the future, Bob should be careful what he wishes for.  We also pointed out that he never did thank us when interest rates went down and the value of his portfolio went up.

We love Bob, he always gives us topics for new articles.

Moral of the Story:

Bonds may be counter intuitive at times.  It is clear that bonds are a better buy today (March 23, 2022) than they were in December of 2021.  However, it is not knowable whether the direction of interest rates in the future will be higher or lower.

If you are holding a bond fund, the rules are different. Bond funds and ETFs are essentially a bet that interest rates will decline.  However, that is a story for another time.

Here Comes the Pitch – Readers’ Discretion is Advised

If you wish to have an adviser when buying a portfolio of high-quality individual bonds, we hope you will consider Scarsdale Investment Group, Ltd.  We provide a valuable set of advantages in our bond buying process:

- Represent individual clients as a fiduciary in the bond market.
- Income allocation planning to maximize the tax benefits of bonds.
- Research regarding the highest quality bonds.
- Access to the bond new issue market.
- Personal education about bonds based on our nondiscretionary practice.
- Targeted offerings for your consideration.
- Very reasonable fees.