TENON FINANCIAL
RETIREMENT PLANNING & INVESTMENT MANAGEMENT

Retirement Planning Insights

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Up Front

My recent podcast appearances

I was invited on two great podcasts in March; one by Sara Grillo and one by Stan the Annuity Man.

The timing of these invitations was completely coincidental. However, in both cases, the topic of discussion was mainly how and why I decided to structure the services and fees of Tenon Financial the way I did.

Sara provides coaching and business development consulting to financial advisors. Stan is one of the top annuity agents in the country.

Both Sara and Stan have great podcasts that focus on different topics. The content of Sara's show is typically around best practices in running and marketing a financial advisory firm, but she also branches out into other financial topics such as crypto, insurance, investments and how best to use LinkedIn.

While Stan's podcast is called "Fun With Annuities," the weekly topics are often far from focused on just annuities. Recent topics include Social Security, Medicare, general retirement planning and income investing.

In my appearance on Sara's show, we dug into why a flat annual fee is generally more fair and logical than the typical percentage of assets fee:

In my episode with Stan, we similarly talked about my views about flat fees, but also chatted about some other interesting topics, such as my thoughts on crypto assets and the blockchain:

For those of you interested in getting a peak into my head to learn why and how I do what I do, you'll definitely enjoy both of these podcast episodes!

-Andy

Retirement Planning News

Eight misconceptions about bonds

On April 5, 2021 *Advisor Perspectives* published the article, **The Eight Great Misconceptions About Bonds.** The article is almost a year old and some of the underlying data has since changed, but the concepts discussed are just as relevant today.

A vitally important trait to understand about bonds is that their prices move in the opposite direction of changes in interest rates. I'll leave the lesson behind that for another day. For now, know that when market interest rates go up, bond prices go down, and vice versa.

The eight myths discussed in the article are:

1) **Rates have to go up – right?** Speculating on the direction of macroeconomic variables like the future level of interest rates is no different than speculating on the future direction of the stock market; no one has the ability to predict it with consistency. Yes, we are at a historic low level of interest rates that has consistently trended downward for decades; but what's to say rates can't be lower? Japan and parts of Western Europe actually had *negative* interest rates for years.
2) **Our country's debt and expanding deficit must result in high inflation leading to higher rates.** Traditional economic principles would say large national debt and deficits will lead to the printing of money, which will lead to inflation, which will lead to higher interest rates. Inflation and interest rates have indeed risen since the article was published a year ago. However, it's difficult to say how much of it was driven by debt and deficits vs COVID-driven supply chain disruptions, increases in wages to get people back to work after the pandemic, energy price spikes due to sanctions against Russia as a result of its invasion of Ukraine, etc.
3) **Income from bonds is near an all-time low.** Yes, in absolute terms, interest rates are still quite low. However, in the broader context of macroeconomics, low rates aren't that problematic. For example, tax rates are much lower today than they were when interest rates were much higher decades ago, and inflation has been relatively modest (until recently). This means the net after-tax buying power of bond interest isn't as bad as the face value of interest would appear. Bonds aren't there to product stellar amounts of income. There more so for relative stability to act as a ballast against the much higher volatility of stocks.
4) **Bonds are better than bond funds as they eliminate interest rate risk.** This is only partially true. While holding individual bonds until maturity eliminates the risk of realizing a decrease in the price of your bond, it still puts you at risk of being stuck in a bond paying low interest if/when the market level of interest rates rises.
5) **If interest rates do shoot up, the bond bubble prediction will come true.** The article does a great job of pointing out how bond funds would have a sizable drop in price if interest rates spike up. But, higher interest rates also means the bonds in the bond fund will start paying higher annual interest. As such, there is an eventual break-even point where the higher ongoing interest offsets the loss the price.
6) **Municipal bonds are safe.** "Safe" is a relative term. It also depends on the specific municipality offering the bond. Some municipalities are in fairly poor health in terms of their deficits, underfunded pensions, waning population (and tax base), etc.
7) **Separately managed municipal bond portfolios provide high income.** The author gives a fairly technical and specific example of how this is not always the case, particularly when a municipal bond is "called," or forcibly redeemed early.
8) **Interest from taxable bonds is always taxed as ordinary income.** I don't especially like the complexity of the scenario the author describes in the article. He gives an example of how a bond (or fund) with an unrealized capital gain can be sold to buy a bond (or fund) paying higher interest. He presents this as a roundabout way to essentially use the long-term capital gains tax rate in lieu of ordinary income tax rates. While I don't think I agree with his view, he nonetheless makes a case of how it's hypothetically possible to not have to pay ordinary income tax rates on bond interest.

Practical Retirement Planning

Possible alternatives to bonds

While I feel all anticipated interest rate increases are already taken into account and therefore bond (and bond fund) prices already reflect expected future rate increases, many people feel bond interest rates will continue to increase, leading bond and bond fund prices to further decline.

With this in mind, many people may be seeking alternatives to bonds and bond funds. However, there frankly aren't great alternatives.

It's important to know how bonds fit into a portfolio and what purpose they have. Contrary to the widely held belief, bonds are not there to produce sizable amounts of income.

While the face amount of interest was much higher decades ago, so was inflation. When adjusted for inflation, the "real" buying power of interest wasn't much better than it's been in recent years.

So, if they're not there to throw off copious amounts of income, what exactly IS the purpose of bonds and bond funds??? They are largely there to act as ballast of relative stability compared to the much more volatile and riskier stock portion of a portfolio.

Yes, the fact that bonds and bond funds throw off a little interest is definitely good. But the real value of them is to have some of your portfolio experience moves in prices that are much more muted than the moves in prices of stocks and other riskier assets.

With that said, if you're afraid of the prices of bonds and bond funds decreasing if/when interest rates rise, what else can you use in place of bonds? Here are my thoughts:

- **Cash in banks**. Cash is ultra-low risk in that there is no risk of losing any of your principal. However, the interest paid is jokingly small; currently about 0.50% to 0.60% for a high yield savings account, and not much better for a certificate of deposit ("CD") that requires you to commit your money for a year or longer. Hence, keeping *too much* cash isn't great option.
- **I Bonds**. I Bonds are functionally savings accounts issued directly by the U.S. Treasury. The upside is they pay interest that's based on current levels of inflation. At the moment, I Bonds are paying over 7% guaranteed interest. But if/when inflation subsides, so will the interest. Furthermore, you're generally limited to buying only $10k per year, per person. Which means you can't accumulate very much. Additionally, you can't take out any money within the first twelve months of purchase.
- **Multi-Year Guaranteed Annuities ("MYGAs").** These are very similar to CDs in that you put money in, and in a few years you get it all back, plus interest. The difference is they're issued by insurance companies. And the early surrender penalties are much steeper than those of CDs. The benefit of MYGAs is the interest rates are better than what banks pay; current about 2% for a two-year MYGA, and about 2.5% for a three-year MYGA. However, while guaranteed to not lose principal, those levels are interest are still not great, especially considering the inflexibility of the multi-year commitment.
- **Fixed Indexed Annuities.** These products are quite complex, often have a five-to-10 year commitment periods and have other unique attributes that are quite different from bonds. A fixed indexed annuity could likely generate average annual interest of 2-4% over its life. As such, it could potentially be used as a replacement for *some* of the bonds in your portfolio. However, early surrender penalties could lead to a noticeable reduction in value if you don't keep the contract for its full length.

As it can be seen, there is no perfect solution for the safe and stable portion of your portfolio; bonds and the other alternatives all have their own unique pros and cons. As such, the best approach may be to use bonds in conjunction with a few of the alternatives.

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