RESEARCH SUPPLEMENT

HELIOS QUANTITATIVE RESEARCH

IMPACT OF RISING RATES

PASSAGE WEALTH™

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UPDATE

Due to the current fixed income market environment, investors with exposure to bonds have been asking two primary questions regarding their portfolio. The first is centered around interest rate movements and whether the current trend is likely to continue in the foreseeable future. The second question, building off the first, is centered around future return expectations when considering the current interest rate environment's direction. Below, we provide insights into both questions using historical data and pragmatic investing principles.

QUESTION 1 – ARE INTEREST RATES GOING TO CONTINUE TO GO UP?

They could, but given the moves we have seen so far, it would be fairly unusual to have further yield increases from this point if the equity markets continue their bull run. It's important to keep in mind that rising yields during periods of positive equity moves is a common and welcomed sign. Investors should want yields to appreciate to a more "normal" level gradually. If rates go up, investors will earn more yield in the future on their less risky investments. The pattern of yields now seems natural, even if the recent moves have felt sudden. Yields have always been volatile but tend to move in a trending direction. It seems logical to assume that the trend from here will be positive, but the recent rise in yields is significant when looking at normal short-term yield moves.

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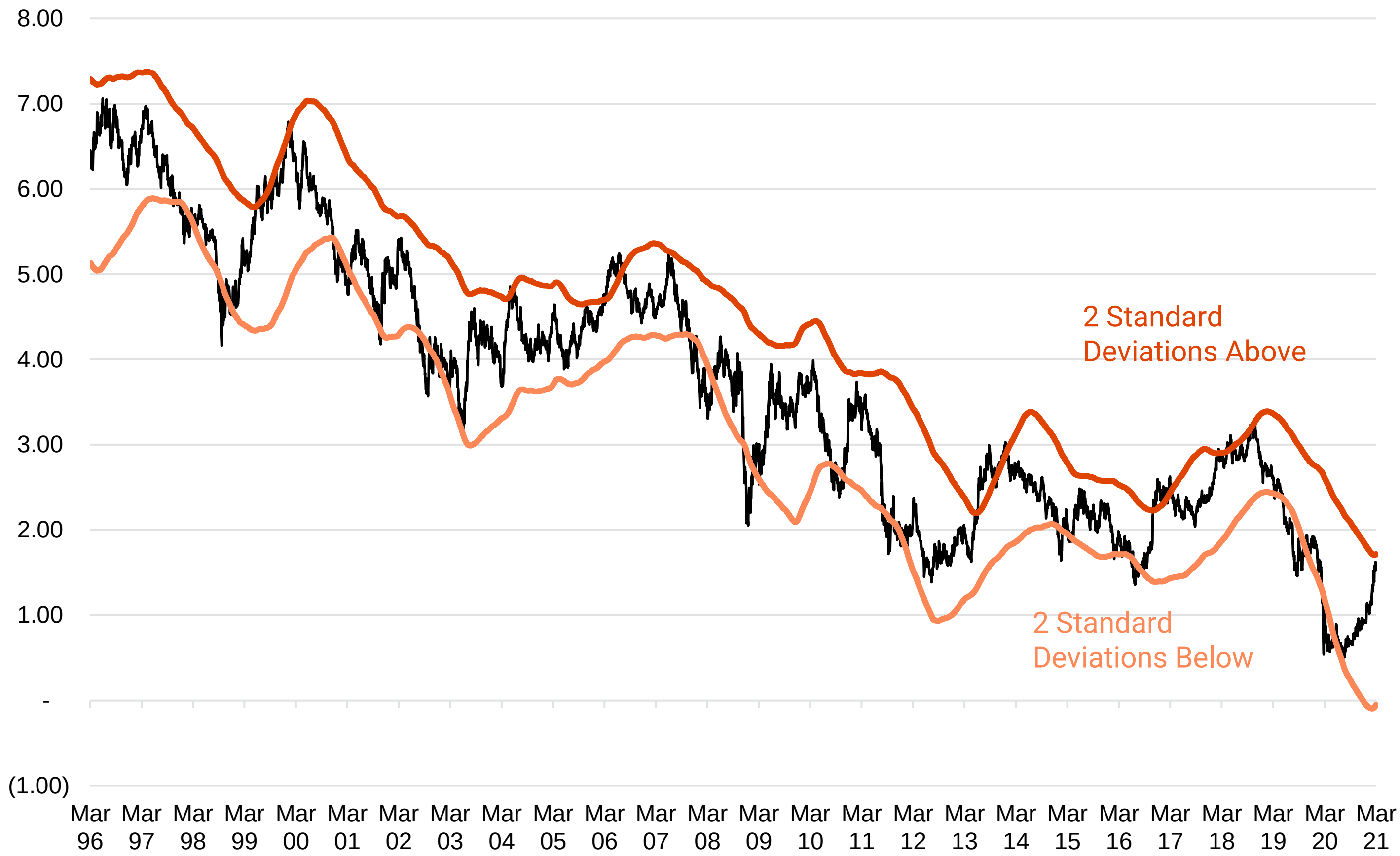
Over the past 25 years, the mean reversion among rates is apparent. The movement in yields tends to be volatile but within a channel of two standard deviation moves.

US 10 YEAR TREASURY YIELD & ONE YEAR STANDARD DEVIATION



Our take: It is likely true that, in the long-term, yields are probably going to go up. If the pace of increases is not too fast and is in combination with positive equity returns, it should be a positive development for most investors. Yields have run up considerably in the past eight months, and, so far, the impact on the markets appears to be normal and within expectations. Further evidence of this is that The Federal Reserve has taken little action during the period of yield curve normalization. Perhaps counter-intuitively, if historical trends continue, the data shows the pressure is more on a downward move in yields in the interim (see above graph). But, should it really matter? Let's examine.

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QUESTION 2 – BONDS ARE DOWN 4% YEAR-TO-DATE. AM I GOING TO KEEP EXPERIENCING LOSSES, AND WHAT DOES A RISE IN YIELDS MEAN FOR MY INVESTMENTS ON A GO-FORWARD BASIS?

The relationship between yields and bond prices is well known. As yields fall, bonds go up, and vice versa. However, after experiencing an almost 40-year period of falling yields and healthy bond returns, should you be fearful of rising yields, and does it mean destruction for my fixed income investments? In short, no. Rising yields in the short-term can lead to negative returns in bond portfolios, but the offset is an increase in the forward expected return in the same bonds.

Bonds are simple investments; the yield on your current bond portfolio should be close to what the total return of your portfolio will be in the future. If you've experienced short-term losses, you are likely compensated with a greater yield in the future.

Let's look at some examples: There have been four occurrences in the last 25 years where the US 10 Year Treasury Yield has jumped by more than 1% in under a year.

Start Date	12/30/08	07/24/12	07/08/16	08/04/20
Starting 10 Year Yield	2.05	1.39	1.36	0.51
End Date	04/29/09	06/20/13	11/30/16	02/25/21
Ending 10 Year Yield	3.11	2.41	2.38	1.52
Change in Yield	1.05	1.03	1.02	1.01
Days	120	331	145	205

Over that time, as expected, the return on both Treasuries and Aggregate high-quality bonds has been negative.

Start Date	12/30/08	07/24/12	07/08/16	08/04/20
End Date	04/29/09	06/20/13	11/30/16	02/25/21
Bloomberg Barclays US Treasury Total Return	-3.80%	-2.88%	-4.79%	-5.48%
Bloomberg Barclays US Aggregate Total Return	0.16%	-2.01%	-3.45%	-3.29%
S&P 500 Total Return	-1.02%	21.18%	4.12%	16.91%
50/50 Portfolio Return	-0.43%	9.58%	0.34%	6.81%

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However, the year immediately following the loss in price has generally been good for the bond returns. It has also coincided with strong equity markets.

Start Date	04/29/09	06/20/13	11/30/16	02/25/21
End Date	04/29/10	06/20/14	11/30/17	02/25/22
Bloomberg Barclays US Treasury Total Return	1.35%	1.38%	1.89%	TBD
Bloomberg Barclays US Aggregate Total Return	8.21%	3.70%	3.21%	TBD
S&P 500 Total Return	41.07%	26.20%	22.87%	TBD
50/50 Portfolio Return	24.64%	14.95%	13.04%	TBD

Our take:

There is no free lunch in fixed income investing. The price of any investment, with yield or price returns, can come with short-term volatility. When looking at historical data, we are reminded that 5% bond sell-offs are common. However, it is important to note two themes when the sell-off happens:

1. The loss of return is not a permanent impairment to the bonds' earning potential.

2. Buying newly issued bonds is more attractive than buying previously issued bonds, such as those you are holding.

While these two points may seem counterintuitive, they have been shown to be true many times prior. For example, those who held treasuries in August 2020 could have been expected to return 0.51% annually. They lost over 5% in value running up to February 2021 but may now potentially return 1.52% annually in the future.

While the short-term price movements in the "safe" portion of a portfolio can be uncomfortable, investors can think of these developments as longer-term positive for their portfolio.

Further, owning some combination of fixed income and equity is a great tool to help dampen short-term pain on either side of a diversified portfolio.

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