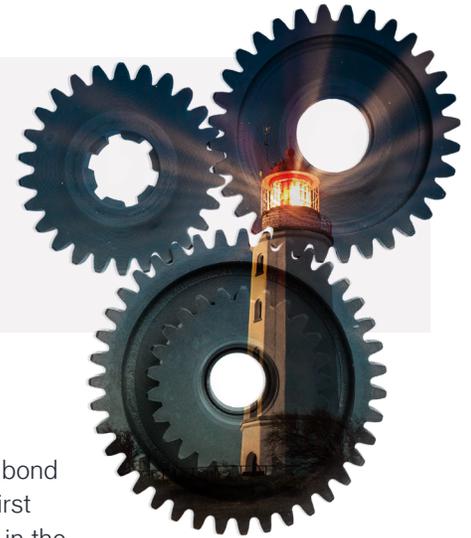


A 401(K) PARTICIPANT'S GUIDE TO BUYING BONDS

With interest rates at historical lows and the stock market achieving new record highs almost daily, many 401(k) participants are wondering what role, if any, do bond funds play in their overall asset allocation. This short guide seeks to help 401(k) plan participants understand the potential benefits of owning bonds, make sense of the different types of bond funds that your 401(k) plan provides, and offer a commonsense approach to bond investing based upon your risk tolerance.



Why Bonds, Why Now?

Historically, the primary reason to buy bonds was to earn a steady, predictable stream of income. In 2021, however, interest rates are at historical lows offering bond investors minimal returns. A logical question therefore is why buy bonds in the first place? The primary reason to invest in bonds now is to offer a buffer or cushion in the event of a substantial stock market drop.

Consider the first quarter of 2020. During this three-month period the S&P 500® Index fell by 19.60% while the Bloomberg Barclay's U.S. Aggregate Bond Index rose by 3.15%. Put another way, a 401(k) participant who was diversified with half stocks and half bonds would have suffered an 8.23% loss. Even a participant who only had 25% in bonds would have incurred a loss of 13.91%, far less than the 19.60% loss incurred by stock-only investors.

Curbing portfolio losses during periods of economic turmoil are critical for long-term success. The reason is because losses and gains are asymmetrical. In other words, a 5% loss is not recovered by a 5% gain, nor is a 20% loss recovered by a 20% gain. As the table below illustrates, the larger the loss, the larger the gain that is required for investors to make their money back.

Winning Through Not Losing Over the Long Term

	75% stocks and 25% bonds	50% stocks and 50% bonds	25% stocks and 75% bonds
Portfolio return for the period January – March 2020	-13.91%	-8.23%	-2.54%
Return needed after March 2020 to breakeven	16.16%	8.96%	2.61%
Difference	2.25%	0.73%	0.07%

Source: Janus Henderson Analytics, April 2021.

Rounding Out a Bond Portfolio

The final step in the process is to complete the bond portfolio. Notice that participant A has another 10% to allocate to bonds while participant E has another 35%. In addition to the Big Three, most 401(k) plans will offer other bond investments. For example, plans typically offer capital preservation options such as a money market or stable value fund. These options are the lowest risk investment available but also offer limited return potential. Another relatively lowest risk investment is a short-term/low duration bond fund. These investments do not guarantee principal but may offer better return potential compared to a money market or stable value fund. Capital preservation and short-term bond funds are typically most appropriate for conservative investors approaching retirement.

Other plans may offer the opportunity to purchase bonds from governments and corporations overseas. The two primary types of funds are international fixed income and global fixed income. International funds invest only in non-U.S. securities while global funds, as the name implies, can go anywhere in the world. These investments tend to be best suited for investors with a moderate to aggressive risk tolerance. The table below illustrates how to put all these pieces together to construct a bond portfolio inside a 401(k).

Participant	Risk Tolerance	Typical Stock-Bond Allocation	Big Three Allocation	Other Bond Allocation	Other Bond Fund Allocation
A	Aggressive	80%-20%	10%	10%	More International/Global
B	Moderate - Aggressive	70%-30%	15%	15%	↑ ↓
C	Moderate	60%-40%	20%	20%	
D	Moderate - Conservative	40%-60%	30%	30%	↑ ↓
E	Conservative	30%-70%	35%	35%	

Conclusion

This short guide was written to help 401(k) plan participants better understand the opportunities of bond investing. To recap, despite low interest rates, bonds have a place in almost every portfolio, even among investors with an aggressive risk tolerance. Approximately half of bond allocations should consider an allocation among the Big Three: toward multi-sector for more aggressive investors and toward core or core-plus for more conservative investors. Finally, for moderate and aggressive investors, the balance of a bond allocation should consider an allocation among non-U.S. securities, while leaning more toward cash and short-term bond funds for more conservative investors approaching retirement.

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Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

S&P 500® Index reflects U.S. large-cap equity performance and represents broad U.S. equity market performance.

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