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Allocation Changes – Fixed Income

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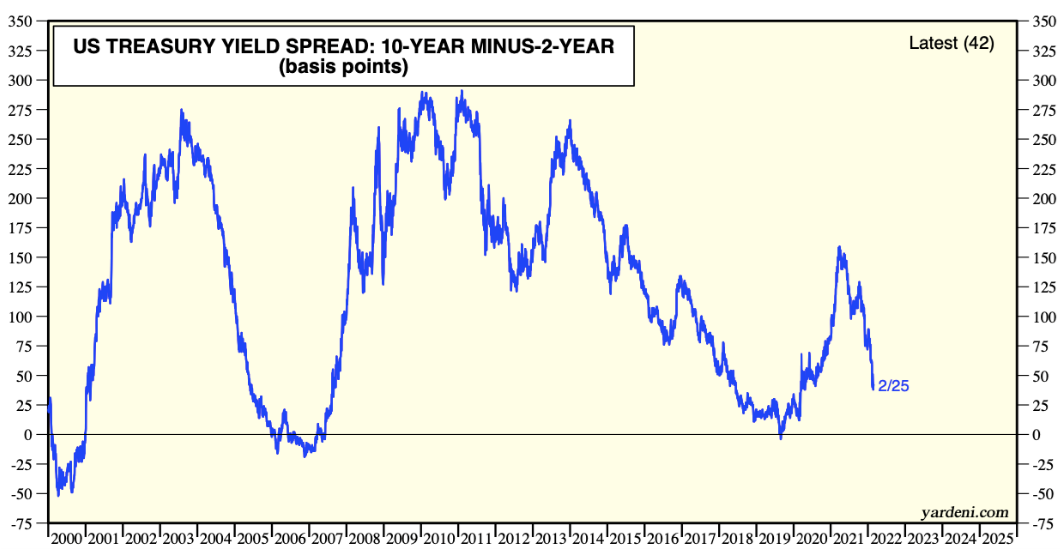
Yesterday we made changes within the Fixed Income portion of your portfolios. The current investment environment continues to be extremely volatile and the economic backdrop continues to fluctuate. Periods such as these require us to be more active in the management of your portfolios. You have seen, and likely will continue to see, more frequent adjustments to your portfolio allocations. Although the Ukraine-Russia issue remains the world's top focus, the reasons for these changes are more directly related to changing monetary policy expectations and Fixed Income asset performance over the last several weeks.

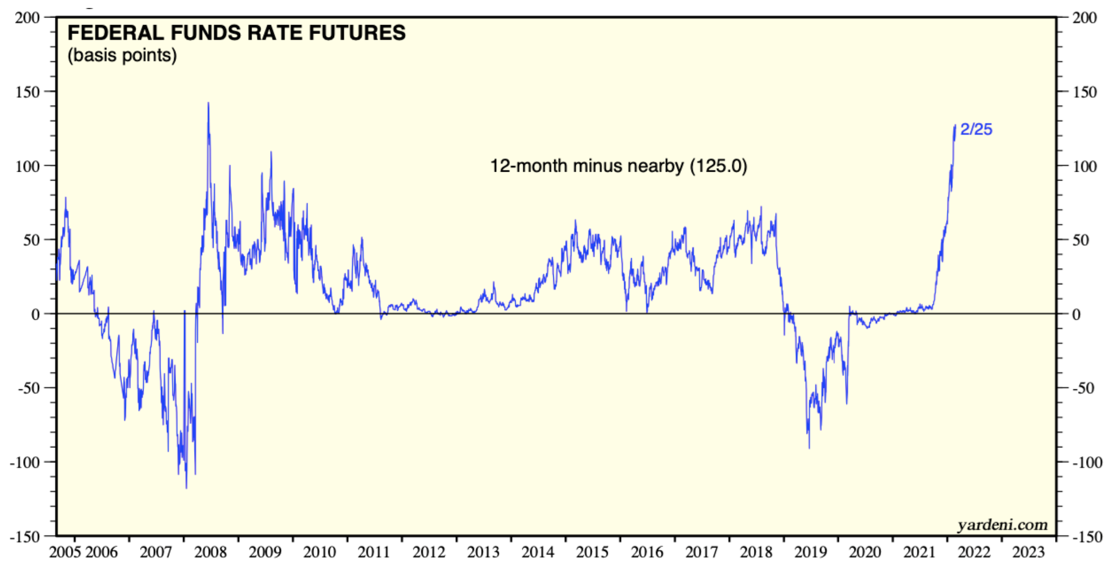
The bond market has started to price in a 25bp (basis point) hike in the Fed Funds Rate instead of 50bps, and a generally less hawkish Federal Reserve. Before the Ukraine-Russia War, there was little doubt the Fed would declare their own war on inflation during their March meeting. It now appears the Fed will back off their aggressive approach to inflation until after things settle down a bit. Bonds have rallied considerably over the last week. The 10-Year Government bond yield has dropped 30bps from its recent high.

Although we would expect adding equity at this point would add value over the next year, we are reluctant to do so. We believe even the most seasoned investor's risk tolerance will be challenged and the potential modest benefit isn't enough. We don't expect stock markets will achieve anywhere near the outsized gains they have provided for the last several years. Investor portfolios continue to weather these volatility storms fairly well (and it's likely far from over), we prefer to be patient. Longer-term returns remain strong. The changes we made are significant but constrained to the Fixed Income asset classes.

We have consistently challenged the consensus notion over the last many years that inflation and interest rates are going dramatically higher, and it's paid off. Interest rates have remained in check and duration has added value while also dampening volatility. We lowered duration as the Fed started to shift to a tighter monetary policy. Although this benefited the portfolios and added value on a relative basis, we've come to the realization that interest rates are simply too low to provide their traditional levels of protection. Although Government Bonds rallied as we considered the potential for a World War, they simply didn't do enough. Yields are too low and inflation is too high. If that's all we get given this environment, we would rather be in cash as our defensive counter position. Additionally, we are becoming increasingly concerned about interest rates exploding higher if geopolitical risk suddenly leaves the arena. With 10-Year yields rallying back down to 1.72%, it was a good time to move some more bonds into cash. Lastly, and perhaps most importantly, the yield curve has flattened to the point that there is almost no yield advantage to owning long vs. short-term maturities. We can now get a similar yield while also lowering our interest rate risk.



We are also changing how we invest your *cash* allocation. Although this portion of your portfolio is designed to be ultra-low volatility, we traditionally don't hold actual cash deposits, instead, we hold this portion of your portfolio in short-term Treasury Bonds. We've been doing this because of the Fed's ZIRP (Zero Interest Rate Policy). Accepting a zero percent return on cash appeared unnecessary to us. Since the front-end of the yield curve was very steep, we have invested the cash allocation in 1-3 year Government Notes and earned something instead of nothing. The Fed Funds Rate is a proxy for cash rates. The expectation is that cash will start earning a comparable yield to short-term Government Notes when the Fed Funds Rate is raised in March and the front-end of the yield curve flattens.



Investing in short-term Treasury Notes has worked over the last 3 years. We use an ETF with the ticker SCHO for this exposure. It has added 1.40% per year above what a simple cash account would have paid. More recently, SCHO has been a detriment to portfolio returns versus outright cash. We think it's necessary to accept a zero percent return until the Fed raises rates, likely at their meeting in a couple of weeks.

Ticker	Name	1 Month	3 Month	YTD	1 Year	3 Years
SCHO	Schwab Short-Term U.S. Treasury ETF	-0.89%	-1.37%	-1.32%	-1.96%	1.40%

Perhaps we should have been quicker in shifting cash allocations back to a cash account. After so many threats of raising rates and then not following through (by the way, the Fed still hasn't actually raised rates and is once again backing off their threats of a much tighter monetary policy), we thought it best to wait them out. This worked well but is now starting to detract from returns. We will use a cash deposit account for our cash positioning until we believe the Fed is done raising rates.

We don't expect this volatility to subside anytime soon and still believe the economy and corporate earnings will emerge just fine from all of this. As always, please contact us if you'd like to discuss financial markets or the economy in more detail.

"Keep calm and carry on" is a popular phrase. Interestingly, it was developed by the British Government to calm its residents at the start of WWII. It continues to be solid advice today.

The Mommaerts Mahaney Team

Jon C Mommaerts, CFP®: Jon is a Principal of Mommaerts Mahaney Financial Services, Inc. He has over 30 years of experience working with professionals and those about to retire. He is a member of the Financial Planning Association, as well as a member of the Preferred Financial Advisors.

J. Matthew Tuccini, CFP®: Matt has over 17 years of experience working in the financial services industry with vast experience in retirement planning, tax strategies, and financial planning.

Robert Kea, CFA: Bob has over 30 years of experience in portfolio management. He was a founding member and Co-Head on Putnam's Asset Allocation Group, which managed $12Bn in both retail and institutional assets.

Jason Rolling, Financial Advisor: Jason has been in the financial services industry for the past 15 years. His financial experience includes retail banking, consumer & commercial lending, bank management at the local, regional and SVP level, wealth management, and financial planning.

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