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Third Quarter 2021

Zero International Bonds

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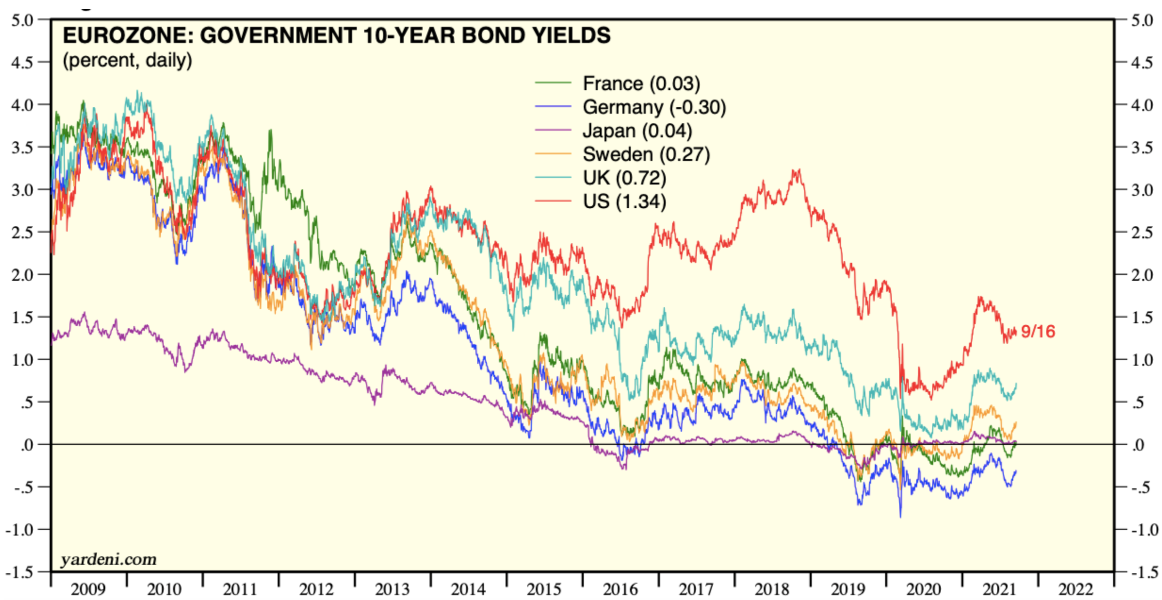
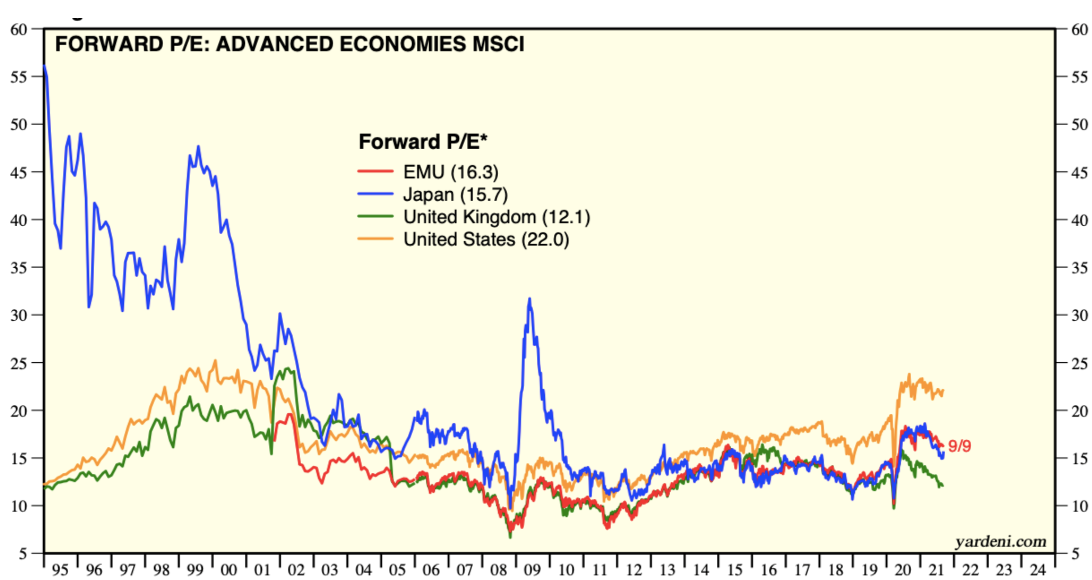
Part 2 of our journey to zero International exposure begins with why MMFS doesn't invest in International Bonds. Our reasoning is straightforward; International Bonds don't provide material diversification benefits or enhance portfolio returns.

Global Bond yields have become increasingly correlated over the last few decades. Globalization has synced world economies with each other. Generally speaking, developed market economies all follow the same global business cycle. This results in each country's central bank enacting the same monetary policies. The world's central banks are effectively coordinating their monetary policies with each other. It would be extremely unlikely for the European Central Bank (ECB) to be raising (lowering) rates while the U.S. Central Bank (The Federal Reserve) was lowering (raising) rates. This creates a situation where global interest rate movements are highly correlated. Therefore, allocating assets across government bonds in multiple countries has no material diversification or return benefit. The graph below shows that although there are minimal differences in yield levels, global bond yields consistently move in the same direction. Therefore, purchasing government bonds from multiple countries provides no material diversification benefit.



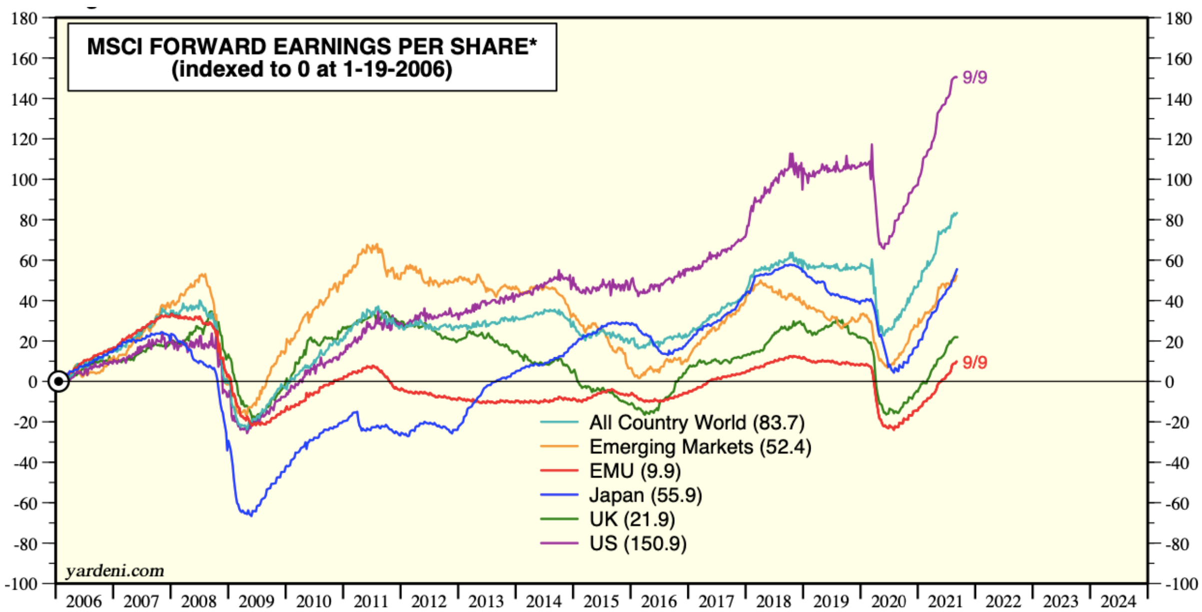
As a quick refresher, in or last article titled *Travel Restrictions*, we differentiated between Strategic (long-term) and Tactical (short-term) allocations. We explained why we systematically underweight International Stock in our Strategic allocation. Here's the reasoning why we further removed the remaining International Stock exposure through our Tactical allocation.

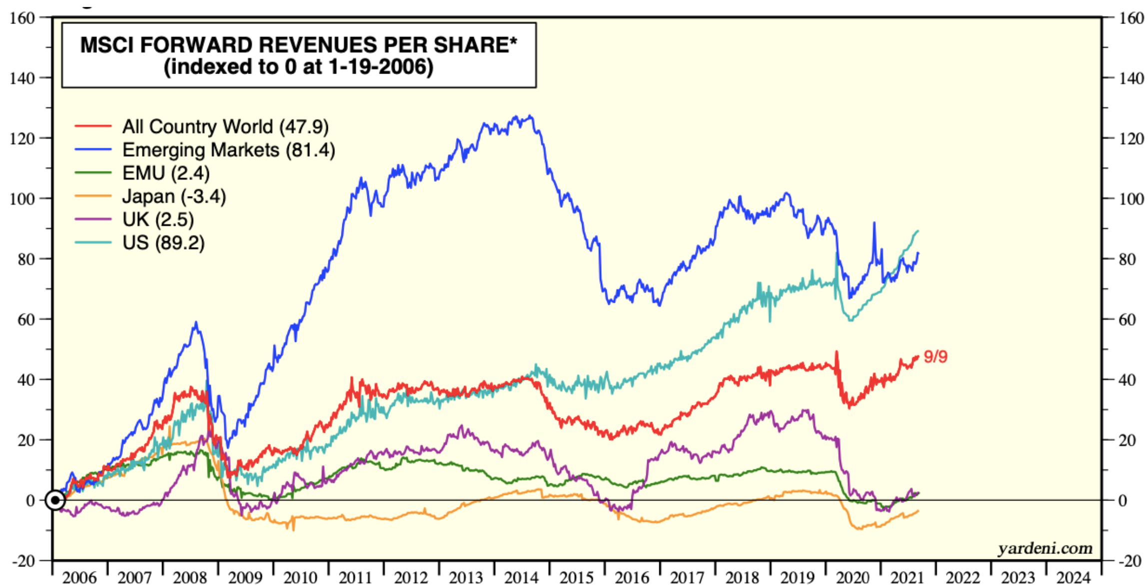
The cornerstone of our equity frameworks is valuation. Valuation measures whether an asset is expensive or cheap. It compares the current relationship between the price and earnings of an asset relative to the historical relationship between price and earnings. Our actual measurement of valuation is a bit more complicated but for purposes of this commentary, let's simply look at price to earnings ratios.



P/E ratios appear to favor International Stocks over Domestic Stocks. International Stocks have lower P/E's and therefore are considered cheaper by that measure. Here's the issue. International Stocks have lower P/E's because they have been continuously growing their earnings and revenues at a much slower growth rate than Domestic Stocks. Buying "cheap" stocks solely on P/E ratios often leads investors into *value-traps*. A value-trap is when something appears cheap based on its P/E ratio but the actual reasoning for the lower P/E is that its future revenue and earnings are likely to be lousy. We often see value-traps occur in stocks whose technology has become obsolete. The Eastman Kodak Company had very attractive P/E's on its way to bankruptcy. Digital photography made Kodak's technology obsolete. That said, we sure do miss Aunt Sally coming over with 8 carousels of slides from her latest vacation.

We are not suggesting International Stocks are the next Kodak. We are simply recognizing that U.S. corporations are growing their earnings and revenues much more impressively than International companies.





Lastly, when we buy International Stocks we expose investors to currency risk. Our process does not hedge currency risk. There are two reasons; Reason 1 is currency fluctuations have historically netted out over the long-term. The second reason is a bit more humbling. We believe we are unable to add enough value with short-term currency hedging that it would offset the cost of the currency hedging. We have spent considerable effort attempting to produce currency frameworks with enough explanatory value over shorter periods to make currency hedging worthwhile. As of now, we have not succeeded. The biggest reason why this has been so challenging for us is our process. We use long-term data sets to test historical financial relationships in the belief that future relationships will follow historical relationships. The Euro is still a relatively new currency. Recall it wasn't that long ago we used German Deutsche Marks and French Francs, which no longer exist. The British Pound wasn't part of the European Union, then it was, and now it isn't. Quite simply, currency data sets are short and unstable. We think the best solution as of now is not to forecast short-term currency movements.

We do expect to travel internationally in the not too distant future. However, for the time being, we will be staycationing.

Safe Travels,

The Mommaerts Mahaney Financial Team

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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.

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