

Insights into Fixed-Income Alternatives February 6, 2023

SUMMARY

The classic 60/40 or 70/30 portfolio that many of us use for our retirement portfolios has been weighed down by the fixed income component for the recent past as interest rates have been much lower than their historical average. The Bloomberg US Aggregate Bond Index has returned 1.43% annualized in the 10 years ended January 31, 2023. Most of us understand that fixed-income is designed to reduce volatility and provide some level of portfolio insurance in the event of a recession or other world disaster, but those low returns have been a high price to pay. Further, we all learned in 2022 than bonds can be risky in the face of inflation and rising interest rates. Hence it is not surprising that many investors have reached for yield. We present some interesting statistics about 4 widely utilized fixed-income alternatives, namely:

- High Yield Bonds
- Business Development Corporations (BDC's)
- Preferred Stocks
- Merger-Arbitrage

EMPIRICAL ANALYSIS

The securities used in the analysis are based on the benchmark indices that are used to manage popular ETF's in each category. No doubt, there are indices with better characteristics, but the 4 benchmark indices we analyze were chosen since each of them is associated with a popular ETF in their respective categories. Further, we understand that the actual implementation of each ETF/strategy has slippage relative to the index due to trading costs and fees. Graph 1 below shows the 10-years returns of each benchmark index as well as the Bloomberg Agg. Table 1 shows salient statistics of each index.

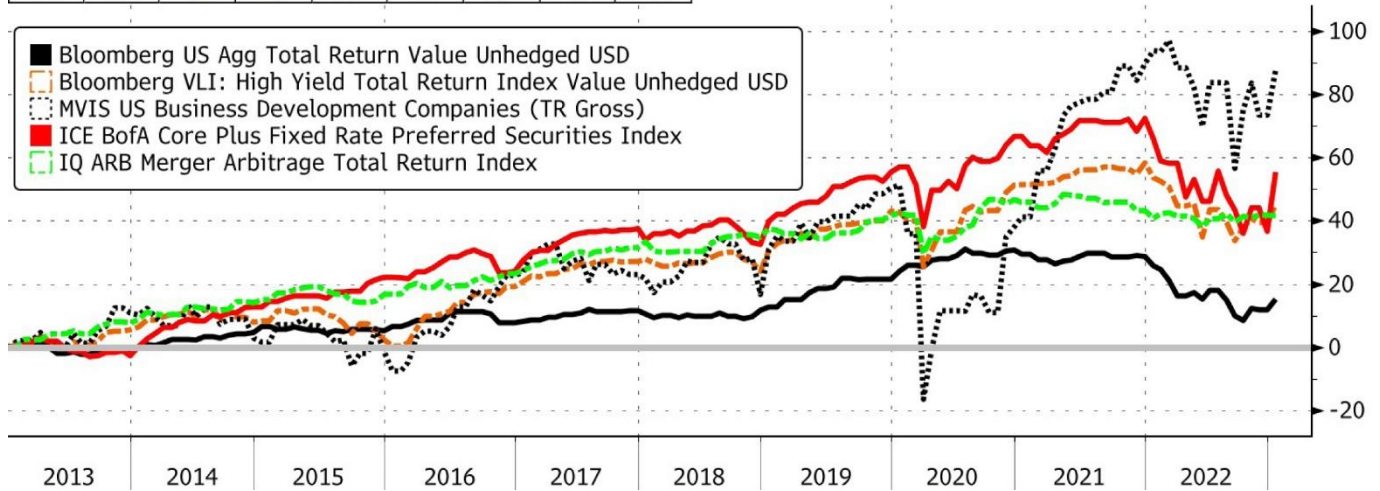
Table 1: Fixed Income Alternatives – Comparable Statistics based on 10-Year History ending 1/31/23

<u>Index</u>	<u>Bloomberg</u>		<u>Correlation with</u>				<u>Sharpe</u>
	<u>Index Symbol</u>	<u>ETF</u>	<u>Russell 1000</u>	<u>Bbrg Agg</u>	<u>Volatility</u>	<u>Returns</u>	<u>Ratio</u>
High Yield Bonds	LHVLTRUU	JNK	0.81	0.47	8.80%	3.80%	0.31
Business Development Corps	MVBIZDTG	BIZD	0.77	0.20	23.20%	6.50%	0.23
Preferred Stocks	POP4	PGX	0.59	0.64	15.40%	4.50%	0.22
Merger-Arbitrage	IQMNAT	MNA	0.34	0.13	4.00%	3.50%	0.60
Bloomberg Aggregate Bond Index	LBUSTRUU	AGG	0.29	N/A	8.30%	1.40%	0.03
Russell 1000	RIY	IWB	N/A	0.29	24.00%	12.50%	0.47

Graph 1: Fixed-Income Alternatives, 10-Year History

LBUSTRUU Index		Settings			Comparative Returns	
Range	01/31/2013 - 01/31/2023	Period	Monthly	No. of Period	120 Month(s)	Table
Security	Currency	Price Change	Total Return	Difference	Annual Eq	
1) LBUSTRUU Index	USD	15.30%	15.30%	-29.72%	1.43%	
2) LHVLRUU Index	USD	45.02%	45.02%	--	3.78%	
3) MVBIZDTG Index	USD	87.67%	87.67%	42.65%	6.49%	
4) POP4 Index	USD	55.35%	55.35%	10.33%	4.50%	
5) IQMNAT Index	USD	41.45%	41.45%	-3.57%	3.53%	
6)						

1M 3M 6M YTD 1Y 2Y 3Y 5Y 10Y



SALIENT POINTS:

- High Yield Bonds and Business Development Corporations are highly correlated with equities.
- Business Development Corporations are extremely volatile – that is not surprising since most are levered and saw large drawdowns during the COVID bear market of March 2020.
- After the bond bear market of 2022, the volatility of the Bloomberg Agg is as similar to that of High Yield Bonds
- Preferred Stocks have higher volatility than we had expected.
- Merger-Arbitrage has the lowest returns of the 4 fixed-income alternatives, but also the lowest volatility, resulting in the highest Sharpe Ratio. Note also the lowest correlation with equities.