Ropes Wealth Mourns Queen Elizabeth II and Suggests Bonds are Back

We all mourn Queen Elizabeth II who passed away at 96 years on September 8 in the 70th year of her reign. While the Queen did not move markets with her words or interfere with politics, she was a global icon of strength and tradition who ruled for seven decades marked by enormous change in the U.K. and all around the world. Her death is another loss in a time of turmoil for Europe and yet another reminder that we are at the end of one era and the beginning of another. Rest in peace, Your Majesty, and thank you for your service.

The European Central Bank made headlines this week by raising their benchmark interest rate from 0% to 0.75%, an eleven-year high and marking the second rate hike in the past three months. Eurozone inflation was 9.1% in August, its highest level on record, forcing the ECB to act decisively to rein in price pressures. They are in good company as central banks in Canada, South Korea, New Zealand, Chile, Singapore, the Philippines, and Australia likewise pushed interest rates higher in response to the global inflation surge. The next Federal Open Market Committee (FOMC) meeting is timed for September 21 and bets continue to grow that the Fed will push rates higher by 0.75% to a range of 3% to 3.25%.

Many have asked if those rate hikes will extend the bond market rout that has characterized the fixed income markets over this last year. The answer is no. Interest rates have already moved sharply to reflect the likely future course of interest rates and reflect the Fed's expected shifts in rates through 2023. Positive real yields now exist, with bond yields higher than expected inflation over the next five years and beyond. Corporate and municipal bonds present more opportunity than any time in the recent past. The so-called TINA (There Is No Alternative) effect has resigned: bonds offer an alternative to stocks with reasonable income again and have reestablished their role as a portfolio hedge to equity risk. Indeed, after spending most of the last year correlated with risk assets, bonds are now zigging when equities are zagging in a welcome shift. Signs of a weaker economy ahead are likely to validate the role of bonds as a portfolio diversifier. That has been the case over the long term, and we believe it will be going forward as well.

You might worry about rising defaults with recession risk looming large on the horizon. Default rates remain around 1%, well below the historical average of 3.5%. Leverage levels are back to below pre-pandemic levels. Companies appear to be well situated to manage a difficult economic environment, though careful security selection should always be employed to ease downside risk. Municipal credit quality is likewise robust with credit fundamentals as healthy as they have been in decades. State and local tax collections have been strong in correlation with the robust economic growth of 2021. Maintaining that credit profile over the long term will be directly tied to how municipal fiscal surpluses are spent. State and local governments that established or bolstered rainy day funds and resisted the temptation to use temporary surpluses to create enduring programs will be best positioned for future downturns.

As a result, we urge clients to reembrace high quality fixed income as an asset class and not stay fearfully allocated to cash or frustrated by recent returns. Better days are ahead for bondholders. At this time of uncertainty and market volatility, portfolio balance is key, and bonds and the strong income they promise in today's prevailing rate environment will deliver for you. Individual securities, if they can be well diversified, are often preferred to funds as the bonds can be held to maturity. Short- and intermediate maturities (not long bonds) are most appropriate as a counterbalance to stocks. We therefore urge you to review your bank balances and cash on the sidelines and get it to work—at least in short-term bonds. As we wait patiently for stocks to stabilize and find momentum in a slower growth, higher interest rate world, now is the time to embrace the opportunities markets offer us in any pockets available. By doing so, we may stay patient, crunch some yield, and ride out the volatility in this market regime.

Thank you for your interest in our investment commentary. If you would like to speak personally with a member of our team at any time, please click **here**.

Ropes Wealth Advisors LLC
800 Boylston Street Boston, MA 02199-3600