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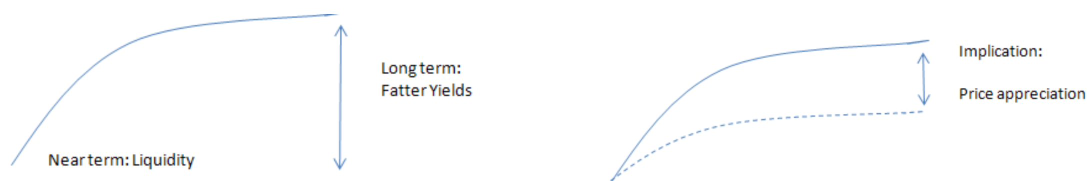
Fixed Income Strategies

Now that rates have bottomed out, the potential for capital appreciation is limited. We believe the fixed income money will flow out to real estate, or dividend paying companies, or High yield bonds, as investors rode the interest rate decrease train as well as the post-2008 crisis capital appreciation swing as well. Now, corporate bond prices have leveled out and interest rates have nowhere to go but up.

Barbell Investing comprises investing in near term maturities for liquidity and far term for yield. Also, importantly, barbell investing assumes a flattening of the yield curve, which implies far term's yield will diminish, which means the price for the long term maturities will appreciate. So, on top of the fatter yields, there will be a capital appreciation.



Let's assume a 3 year bond is selling at 1,000, or par, and coupon is 5%. Then the annual yield would be 5%. However, if the market yield decreases to 4%, this would imply a price of roughly 1035, or a 3.5% capital appreciation.

Market Rate (Target Rate)	4.00%
Coupon Rate	5.00%
Reinvestment Rate	3.74%
IRR	3.74%

Spread	-0.26%
Lower Purchase Price	

Par	1,000.0
Purchase Price	1,035.0
Capital Gain	- 35.0
Coupon	150.0
Reinvestment	5.7
Total Additional Cash Flow	**120.7**

Disbursed Cash Flow Table

	0	1	2	3	Total	% of Total
Coupon	0.0	50.0	50.0	50.0	**150.0**	**124.29%**
Capital Appreciation	0.0	-11.7	-11.7	-11.7	**-35.0**	**29.00%**
Reinvestment	0.0	0.0	1.9	3.8	**5.7**	**4.71%**
Total	**0.0**	**38.3**	**40.2**	**42.1**	**120.7**	

Cash Flow Table

	0	1	2	3
Cash Flow	-1,035.0	50.0	50.0	1,050.0
IRR	3.74%			

IRR Growth

	0	1	2	3
Cashflow growth at IRR	1,035.0	1,073.8	1,114.0	1,155.7
Annual Growth		3.74%	3.74%	3.74%

Laddered investing involves purchasing maturities along the yield curve and rolling the yield by reinvesting the proceeds from matured securities into the long term tail of the yield curve, thereby mitigating interest rate risk and receiving predictable returns.

We would like to point out the steepness of the yield curve is most prominent from years 5 to 10, then flattens afterwards. So, the sweet spot is from 5-10 years, when implementing this strategy. One could allocate 10% of capital on an annual basis from year 1 to 10, and roll the near term maturities with a 10 year maturity in Year 11 and so on.

Duration is the change in price from 1% change in the rate. Long dated securities are more volatile to the rate changes while near term securities don't fluctuate as much. Traders are more willing to trade in and out of long term as maturity is still years away, so they could enjoy higher yields for longer periods of time, whereas short term securities don't offer a long term benefit to holders.