CONVERSATION GUIDE NO. 3

ACTION PLAN: REALLOCATING YOUR CLIENTS' CASH

THE GREAT CASH REALLOCATION

Helping Clients Reinvest Cash Now

INVESTMENT PRODUCTS: NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE

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INTRODUCTION

Due to recent interest rate hikes, many investors are holding surplus cash, often with a smaller allocation to bonds than may be appropriate based on their goals. Reassessing asset allocation offers a chance to reintroduce investors to the core role that bond funds play in a diversified portfolio. It also serves as an opportunity to introduce clients to other fixed income offerings and balanced portfolios to ease them back in the markets. This guide provides financial professionals with discussion points on:

1. THE IMPORTANCE OF BONDS IN ASSET ALLOCATION
2. MAINTAINING YIELD THROUGH INTEREST RATE CYCLES
3. THE BENEFITS AND RISKS OF ALTERNATIVE BOND EXPOSURES

1. THE IMPORTANCE OF BONDS IN ASSET ALLOCATION

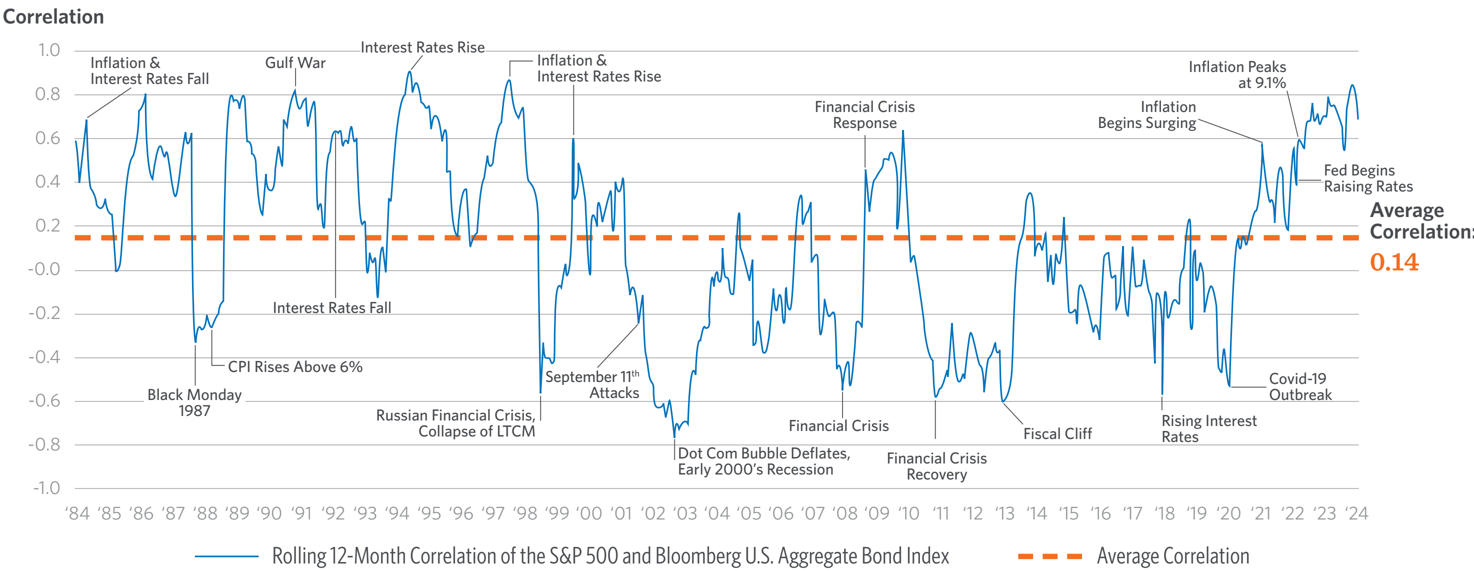
Some investors have avoided bonds recently because the returns have been so tightly correlated to equity performance. Other investors may be waiting for opportunities to rotate back into higher-returning asset classes. As the economy moves into a new cycle, the role bonds play in a diversified portfolio is worth revisiting.

DIVERSIFICATION AND THE CORRELATION OF BONDS TO EQUITIES

We have recently experienced a period in which stocks and bonds have been highly correlated. However, during stock market crashes and times of uncertainty in the equity market, the performance of stocks and bonds tends to decouple, with medium- and longer-duration bonds showing disproportional historical outperformance, which provides diversification when investors benefit from it the most.[1]

Investors questioning the importance of a bond allocation may be focusing on the past decade where, within that narrow view, the recent rise in correlations can appear material. When taking a longer view, however, we can see that stocks and bonds have had a very weak correlation on average.

12-MONTH CORRELATION OF U.S. STOCKS AND BONDS
FEBRUARY 28, 1983 TO FEBRUARY 29, 2024



Source: S&P, Bloomberg.
Past performance is not indicative of future results. It is not possible to invest directly in an index, which also does not include the application of fees.

INVESTOR CONSIDERATIONS

Allocation to bonds plays a critical role in a diversified portfolio, particularly when current income is a priority.	While they sometimes rise and fall with stocks, **bonds act as an equity hedge during points of stress in the economic cycle.**	Consider **balanced portfolios** to help diversify risk in uncertain market environments.

[1] "Decoupling," The Journal of Portfolio Management, Spring 2002
Diversification does not guarantee a profit or protect against a loss.

2. MAINTAINING YIELD THROUGH INTEREST RATE CYCLES

If interest rates fall in 2024, the yield for cash investments will also decline. Extending duration by allocating to an appropriate bond category can help recapture lost yield when interest rates fall. Additionally, a drop in bond yields can create total return scenarios that exceed a bond's yield to maturity. Holding several bond categories with different durations and credit exposures can help preserve yield and decrease reinvestment risk.

While bonds can help diversify a portfolio, a bond allocation will always be more volatile than an allocation to cash. Investors may have shorter time horizons, and investors understandably may hesitate to take on too much credit risk or volatility. Discussing the various bond categories, as well as the merits of a balanced portfolio, can help investors choose the appropriate exposure to match their risk tolerance. *Clients do not need to push duration or credit risk too far to create more diversified income sources.*

SHORT-TERM AND ULTRA-SHORT BONDS:
These bonds cater to investors with limited time horizons, providing opportunities for income without exposing the portfolio to prolonged market fluctuations.

MUNICIPAL BONDS:
Municipal bonds offer tax advantages, presenting an attractive option for risk-averse investors seeking a more reliable income stream.

EXTENDED DURATION AS A RECESSIONARY HEDGE:
When clients can tolerate greater principal fluctuations, investment-grade corporate bonds with medium-to-long duration can offer diversification and increased income opportunities.

INVESTOR CONSIDERATIONS

Diversifying across income sources with various durations can be advantageous through an entire rate cycle, mitigating inflation and reinvestment risks.

Choosing shorter-duration bonds or municipal bonds may be appropriate for risk-averse investors seeking to add diversification to a cash-heavy portfolio.

Focusing on an actively balanced portfolio can help keep allocations in line with goals and risk tolerance.

3. THE BENEFITS AND RISKS OF ALTERNATIVE BOND EXPOSURES

Diversifying bond exposures beyond traditional fixed income instruments can be an effective strategy for investors seeking to optimize risk-adjusted returns.

Here are some benefits and risks of alternative fixed income options to consider in asset allocation discussions:

ALPHA-GENERATING ALLOCATIONS

High-yield bonds, characterized by their higher coupon rates, provide investors with the prospect of higher returns. However, the potential for higher returns comes hand in hand with increased credit risk, requiring investors to carefully assess and manage their risk tolerance within these allocations. Investors can also consider using a 60/40 portfolio (60% stocks and 40% bonds) for their core fixed income exposure, adding return potential with the benefit of maintaining a consistent exposure of fixed income relative to equities.

UNCORRELATED ALLOCATIONS:
FLOATING RATE AND INFLATION-PROTECTED BONDS

Floating rate bonds and inflation-protected bonds offer unique features that can enhance portfolio resilience and may merit some attention given the uncertainty of inflation and interest rates. Floating rate bonds, with their interest rate adjustments tied to prevailing market rates, provide a shield against interest rate risk. On the other end of the spectrum, inflation-protected bonds act as a safeguard against the erosive effects of inflation, ensuring the purchasing power of invested capital is preserved.

KEY TAKEAWAYS

Cash has been appealing due to recent interest rates, but **too much cash can hamper a portfolio** in the long term.

Bonds are a portfolio stalwart due to their competitive yields and the benefits of diversification.

Bond investors don't have to take excessive risks to diversify their income. In fact, bonds can help mitigate many risks in a balanced asset allocation plan.

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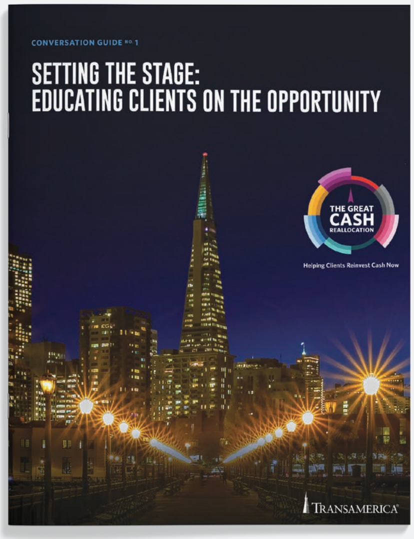
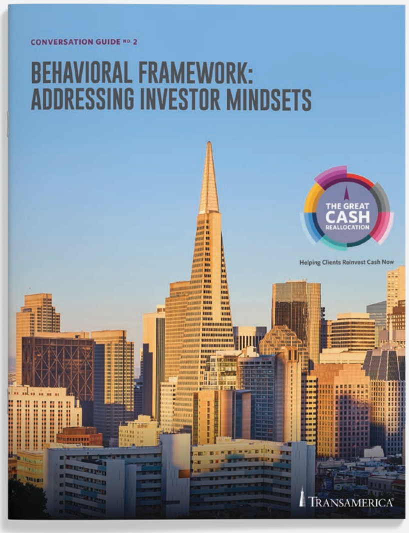
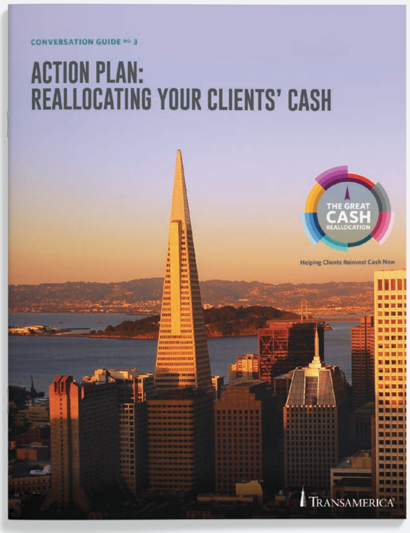


Setting the Stage:
Educating Clients on the Opportunity



Behavioral Framework:
Addressing Investor Mindsets



Action Plan:
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NOTES

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IMPORTANT INFORMATION

Investments are subject to market risk, including the loss of principal. Asset classes or investment strategies described may not be appropriate for all investors.

Fixed income securities are subject to risks including credit risk, interest rate risk, counterparty risk, prepayment risk, extension risk, valuation risk, and liquidity risk. The value of fixed income securities generally goes down when interest rates rise, and therefore the value of your investment in the fund may also go down. Changes in interest rates, the market's perception of the issuers and the creditworthiness of the issuers may significantly affect the value of the fund.

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