

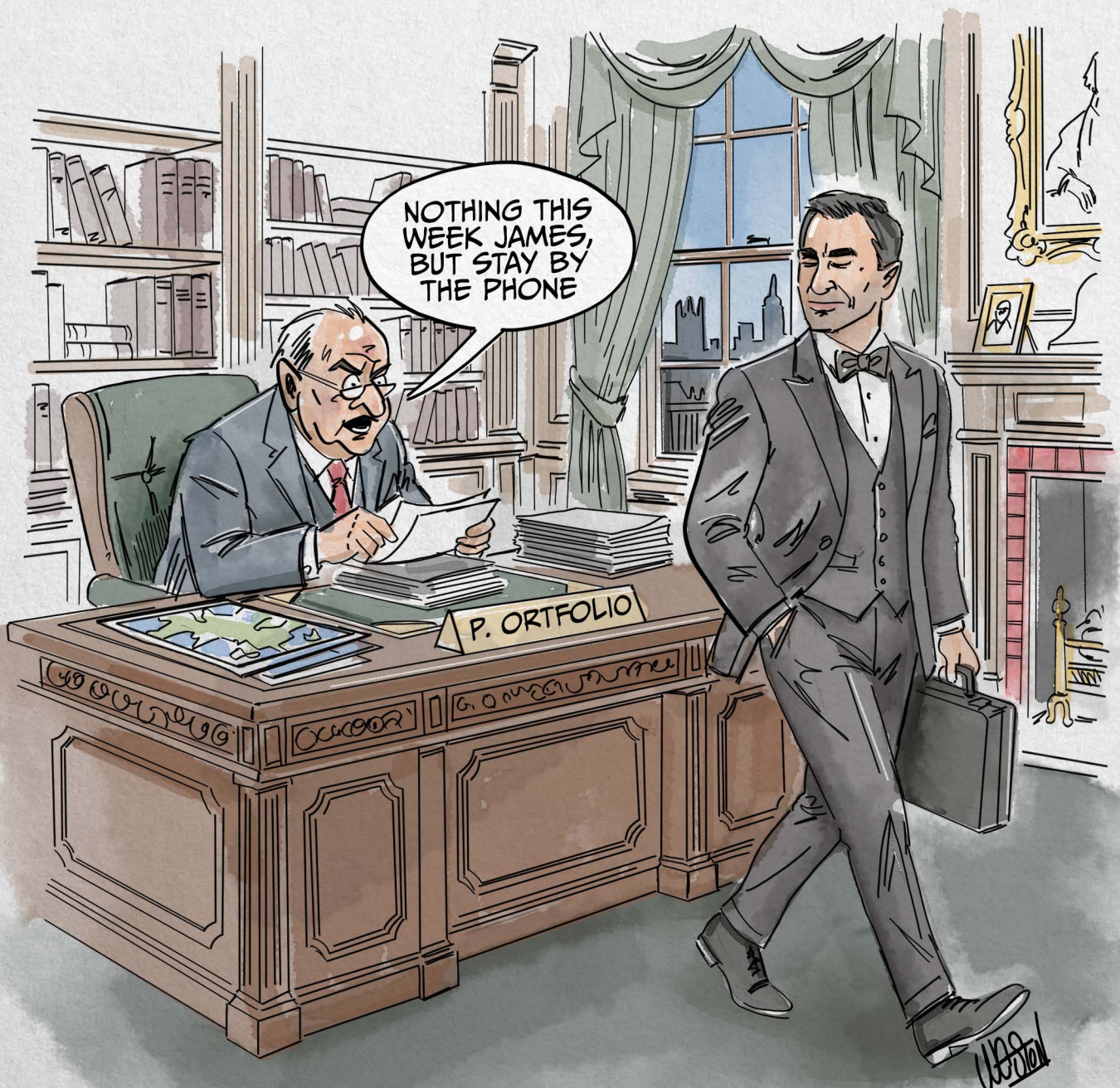
INSIGHT

THE GREATEST WEALTH IS **YOUR PEACE OF MIND...**



BARNETT
RAVENSCROFT
WEALTH MANAGEMENT

You don't need bonds... until you need them



You don't need bonds... until you need them

There are few investments easier to criticise than high-quality bonds during a strong equity market. When share prices are rising, bonds rarely look exciting. Their returns may appear modest, they can attract little attention, and investors can be left wondering whether they would have been better off owning more equities instead.

In many respects, this is exactly how bonds are supposed to feel.

The principal role of high-quality bonds in a long-term portfolio is not to maximise returns. Equities are generally better suited to that task. Bonds are held to provide an expected degree of stability when the growth assets in a portfolio are under pressure, and perhaps to help meet spending needs without having to sell equities during a sharp market fall.

Investors may therefore spend years questioning why they own bonds, only to be grateful for them when markets take a turn. You don't need bonds until you need them. Unfortunately, nobody knows in advance when that moment will arrive.

The price of protection

Owning bonds comes with a cost. Every pound held in bonds is a pound that could have been invested in equities. Because equities offer higher expected returns, the presence of bonds can reduce the upside enjoyed by a portfolio during strong markets.

That opportunity cost might be thought of as an insurance premium. Like most insurance, it can feel expensive when nothing goes wrong. A household may pay buildings insurance for decades without making a claim, but that does not mean the cover was unnecessary. Its value lies in protection against an event that would be difficult to absorb unaided.

The premium will not be the same for every investor. The right amount any investor should own in bonds will be specific to their circumstances. It will be a trade-off between the need for return to meet spending goals, and the ability to withstand swings in portfolio value, both financially and emotionally. Engaging with a good financial planner will help investors navigate this balance.



Figure 1: Owning bonds carries the cost of missing higher expected returns available from stocks

Sources: Albion Strategic Consulting. Data source: Inflation: UK RPI (31/01/88), UK CPI (thereafter). Bonds: Albion Short Gilt Index (0-5). Equities: Albion World Stock Market Index. Returns in GBP after inflation. Period: 02/79 - 12/25.

Higher yields are not automatically bad news

Bond markets have returned to the headlines. The yield on the 10-year US Treasury recently moved above 5%, reaching levels not seen since before the Global Financial Crisis. Commentators do and will continue to look for cause and effect. Stubborn inflation, government debt levels and corporate debt issuance, to name a few.

A rise in yields causes the price of existing bonds to fall, whilst conversely leaving investors enjoying new higher yields going forward.

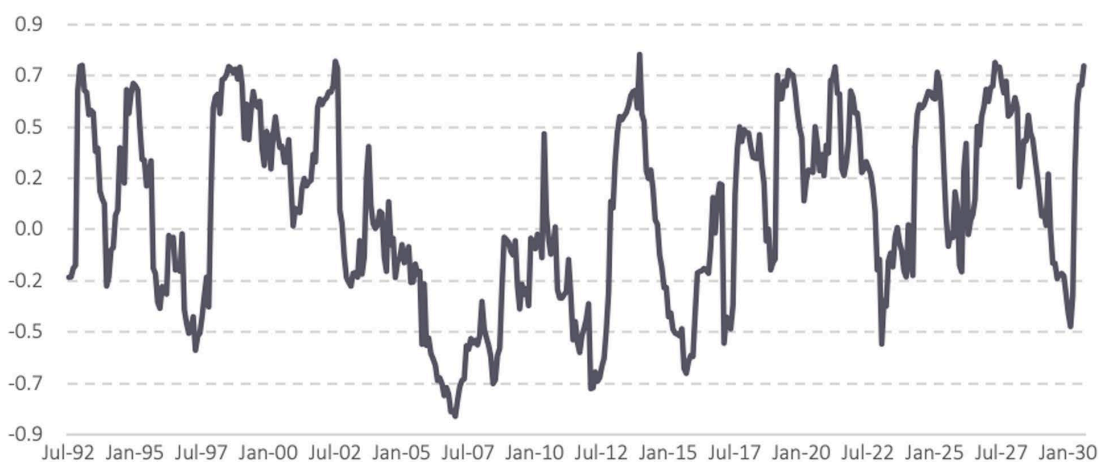
None of this tells us where yields will go next. They may rise further, fall, or remain elevated. Markets continuously incorporate changing expectations about inflation, growth, government finances and interest rates. Today's yields reflect the market's view on the future based on all available information.

Diversification does not guarantee patterns in returns

It is often expected that equities and bonds move in opposite directions. At times they do, and that relationship has often been helpful during equity market stress, but this behaviour is by no means a rule.

Put simply, correlation describes the extent to which two investments have moved together. A positive figure means they have tended to move in the same direction, while a negative figure means they have tended to move in opposite directions.

More recently, stock and bond correlations have risen. That can be uncomfortable because both parts of a portfolio may fall (or rise) together. Yet it is not unprecedented, nor does it mean that diversification has ceased to work.



Bonds moving in the same direction as stocks Bonds moving in the opposite direction to stocks

Figure 2: 1-year monthly rolling correlations between global stocks and bonds, Jan-88 to Jul-26

Source: Albion Strategic Consulting. Data source: Albion Research Indices (see smartersuccess.net/indices for more details). Global stocks: Albion World Stock Market Research Index. Global bonds: Albion Global Short Bond Index (0-5, GBP). Monthly data in nominal terms, in GBP.

Forecasting is not a reliable defence

Periods of change naturally tempt investors to act. If yields appear high, should maturities be extended before they fall? If further rises are feared, should bonds be avoided until the outlook feels safer? These questions sound reasonable, but answering them successfully requires forecasting both the direction and timing of complex markets.

There is little evidence that this can be done consistently. Studies show that many professional fixed-income managers fail to outperform suitable benchmarks after costs, and underperformance tends to become more prevalent over longer measurement periods. Data from S&P (SPIVA U.S. Scorecard, mid-year 2026) show that over 20 years in the US just 13%¹ of professionals have done so successfully to June 2026.

Bond allocations in a sensible investment portfolio

Not all bonds provide the same protection. Longer-dated bonds are generally more sensitive to changes in interest rates, and lower-quality bonds can behave more like equities.

Sensible investing requires a risk-focused and process-driven approach. To understand investment risk, you need to accept that the future is uncertain and build sensible expectations of asset class behaviour and the rewards available.

The defensive assets portfolio is designed to provide protection from equity market crashes and lower volatility than equities.

- **Higher quality bonds:** Lending to creditworthy governments and companies reduces the risk that promised payments are not made.
- **Shorter-dated bonds:** Limiting maturity reduces price sensitivity to large changes in interest rates.
- **Globally diversified:** Holding bonds from many issuers and markets avoids relying unnecessarily on a small number of companies or countries. Currency risk of overseas bonds is also hedged.

These choices are deliberately unexciting. The aim is to give the portfolio a dependable defensive component, as the chart below illustrates, showing the largest peak-to-trough drawdown within each calendar year of global equities, and the corresponding performance of bonds in the same period.

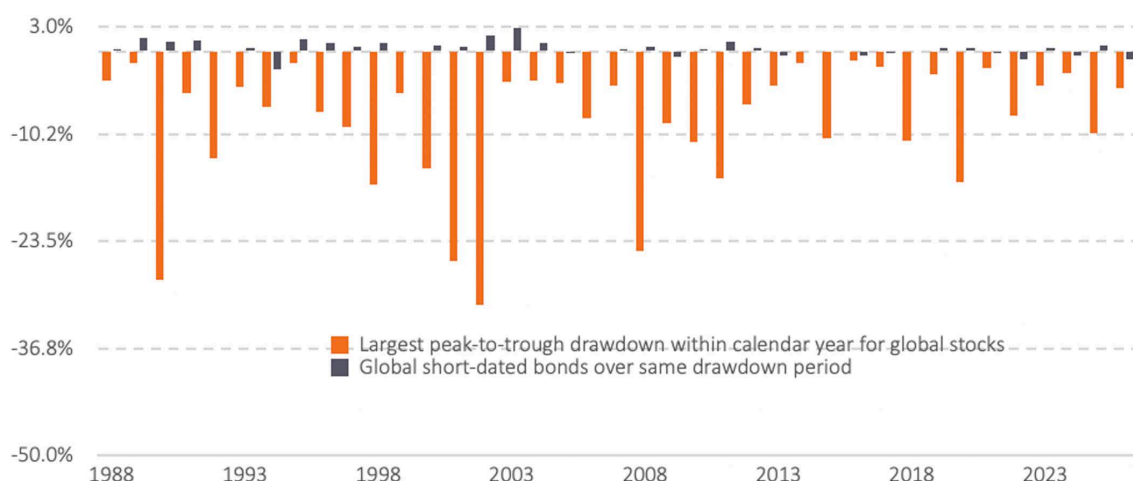


Figure 3: Bonds continue to do what bonds do best, Jan-88 to Jul-26

Source: Albion Strategic Consulting. Data source: Albion Research Indices (see smartersuccess.net/indices for more details). Month-to-month data for Albion World Stock Market Research Index used to calculate peak-to-trough within calendar year. Albion Global Short Bond Index (0-5, GBP) represents bond return over same period. Data in nominal terms, in GBP.

Investors do not own bonds because they expect them to be the hero of the portfolio every year. They own them because, every so often (usually when most needed), they are.

End notes

1.

Category: Investment-Grade Intermediate Funds. Universe used due to being the largest sample size over the period of the study. Some other categories fared (a little) better, others much worse.

Other notes and risk warnings

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