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TIME TO BE A BUSINESS OWNER!

By Mark Pearson, President & CIO of Nepsis Inc. from InvestingWithClarity.com Blog

"Since 1926, owning businesses (investing in equities) has been the best path to creating wealth - earning 9.6% vs. bonds at 5.5%."

Source: 1926-2011 Ibbotson Yearbook, 2012.

For a couple of years now,

I have been warning investors about the dangers involved with owning bonds in their portfolios.

Why Are Bonds Risky?

The answer is simple. Interest Rates are at historical lows while the U.S. economy continues to improve.

Yes, it is true that if you hold a bond throughout its duration, you will more than likely get your principle back. However, in a rising interest rate environment, many investors choose to sell their lower yielding bonds and purchase new bonds in favor of a higher yield and longer duration. Many investors do this because they think it is a less volatile instrument, but history does not support that notion.

As we look over today's landscape, we see the 10 Year Treasury hovering a round 2.40% to 2.50%. This yield is down from the start of the year when the 10 Year was at 3.02%.

Yields have moved lower in 2014 for various reasons; this is a sharp contrast to 2013 when the 10 Year yield went from 1.71% to 3.02%. Obviously, a big move!

The debate still rages on as to when we will see a sustained move up in interest rates from the historical lows we are presently experiencing. Lots of intelligent people are working hard to answer this very big question.

From my perspective, it's an easy decision. If you were to look at long-term trends in interest rates, you would find that they have moved to these all-time lows over the course of several decades (over 32 years). It is my belief, that although we don't really know when we will see a sustained move up in interest rates, it is logical to say that even if they went much lower, it would not have a substantial benefit to one's investment portfolio.

At this point in the interest rate cycle, I really believe that many investors do not understand the potential risks they are taking in the long-term when investing in longer term bonds at these historically low rates.

To add fuel to the fire, many historical studies have been done that look at the volatility of bonds and interest rates relative to equities. I believe the results would surprise many, as history has shown bonds to be more volatile than stocks! I know, hard to believe. Remember what happened to bond prices in 2013?

Obviously, there are many variables that go into these studies, but one thing is for sure: the statistical benefit of owning bonds today is very low. As I often say to investors: you must view bonds as a diversification tool and beta mitigator during volatile periods in the equity markets. However, it is the stock market volatility that is creating, and will continue to create, opportunities in the future to invest in great businesses at lower prices.

Despite today's low interest rate environment, I do believe that for many portfolios, bonds have a place for diversification. However, it is important for investors to understand why they own the bonds in the first place and also know that they are not going to be great investment tools in the near future.

This leads me to Ibbotson information at the top of this piece. As I have said for many years, I believe the best path to creating wealth is being an investor in businesses, not the stock market. It's an important distinction. Market corrections create the opportunity to invest in specific businesses, like a business owner would, with a long-term view of value and growth potential of those businesses.

At the end of 2014, stock market volatility picked up and the U.S. stock market sat around its historical average valuation… investment opportunities are coming and media noise will abound.

As we push on in 2015, there is no doubt in my mind that the greatest opportunities for investors will be based on viewing the companies they own as long-term investments and ignore the short-term noise. Volatility will undoubtedly bring great opportunities in the future.

Invest with Clarity™! — Mark Pearson

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