for Changing Bond Markets

Flexible Income Strategy Can Use Different Kinds of Fixed Income Funds

With the Flexible Income strategy, we have a wide range of fixed income options and alternatives at our disposal. Here are just some of the options in our tool box:

Bond Fund Substitutes

Lower risk total return funds include a variety of investment strategies with a history of volatility similar to that of bond funds. Because these funds are less focused on bonds, they are less affected by fluctations in interest rates or the market's perception of credit risk.

These substitutes include some very conservative balanced funds, merger arbitrage funds, covered call strategies, and diversified multi-asset funds. Each of these funds has its own risks and we monitor each on its own merits – but they can be valuable alternatives when traditional fixed income falls under pressure.

Foreign and Emerging Market Bond Funds

Foreign and emerging market bond funds don't necessarily move in sync with domestic bond funds, and so they can be diversifying alternatives. They may benefit from currency fluctuations (such as a falling dollar) and from the market's perception of economic strength elsewhere on the globe.

These funds generally use only fixed income securities in their portfolios, often issued by governments as well as corporations. Our Flexible Income approach may attempt to take advantage of those that are doing well in the current market environment.

Short and Ultra Short Term Bond Funds

Funds with durations of three years and less, offer very low yields, but these funds remain fairly stable when interest rates rise, and they offer a relatively safe haven during volatile times in the bond market.

Floating Rate Funds

These funds invest in bank loans, which reset interest rates based on increases or decreases in a benchmark (usually the LIBOR rate). This potentially insulates these funds from the negative impact of rising rates and allows them to benefit from higher yields as rates rise.

There are risks, of course, and we use these funds gingerly. Companies that use bank loans for financing tend to have lower credit quality and the market for these loans can lack liquidity. Floating rate funds may be dicier than most individual investors may like, but they can be useful within a professionally managed portfolio like the Monthly Flexible Income Portfolio (MFIP).

High Yield Bond Funds

Bonds of lower credit quality issuers have had a strong run lately and credit spreads (the difference between BBB yields and 10 year US Treasury yields) are now "normal." The easy money may have already been made in this area, but the added yield these funds offer may yet be attractive if overall rates remain flat, and they could cushion the impact of small increases in interest rates.

We use high yield bond funds with care because there are risks here. These funds would suffer, for example, if default rates rise or if interest rates jump dramatically.

Inverse Treasury (rising rate) Funds

Funds that move in the direction of interest rates (and opposite the direction of bond prices) make money when rates rise and lose money when rates fall, the inverse of regular bond funds. Most are quite volatile, but can be useful within a professionally managed portfolio.

Treasury Inflation Protected Securities (TIPS)

TIPS tend to perform well in either a deflationary or inflationary environment, although they don't perform well when rates rise suddenly.

TIPS can be a valuable tool, however, if the market's perception is either future weakness or that rates are being artificially held below inflation (and therefore future inflation will be difficult to maintain). Once perception changes and rates begin to increase, TIPS become similar to longer-duration treasury securities and could become volatile. These multi-faceted instruments can be useful in our dynamic portfolios.

Putting these Tools to Work

These various devices are some of the tools we can use in the Monthly Flexible Income Portfolio (MFIP, on page 4 of each monthly issue of NoLoad FundX newsleter).

It hasn't always been smooth sailing since we added the MFIP to NoLoad FundX in 2005, but the MFIP has managed to hold riskier bond funds when it's been to our advantage, and then shifted to lower risk funds in more volatile periods in the market.

We don't know where the bond market will take us a year from now or two years from now. We do know how important it is to stay flexible and disciplined in our ability to shift our portfolios as market conditions dictate, and we take comfort in having so many valuable tools at hand.

Flexible Income At-A-Glance

- Primary goal is low volatility, rather than total return or monthly income.
- Focus on net portfolio performance rather than current yield.
- Less correlation to interest rates than a portfolio composed of only bonds.
- Invests in a combination of bond funds (Class 5 in NoLoad FundX) and low volatility funds (Class 4).

How You Can Access the Flexible Income Strategy

Monthly Flexible Income Portfolio (MFIP)

Subscribers to NoLoad FundX have access to the Monthly Flexible Income Portfolio (MFIP). The MFIP offers explicit guidance on what bond funds to invest in now, and when to shift to different funds.

The MFIP invests in funds and ETFs that are widely available on broker platforms and incorporate a 90-day hold to avoid typical broker restrictions or fees.

The MFIP may be used on its own or in conjunction with equity portfolios such as the Monthly Upgrader Portfolio (MUP) to form a balanced portfolio.

Mutual Fund

DAL also manages a mutual fund that uses the Flexible Income strategy. For more information, go to www.upgraderfunds.com.