The Milwaukee Company
Wealth Management

MEDIA CONTACT:
Emily Willms
ewillms@themilwaukeecompany.com
262-238-6980

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Investors Should Be Wary Of Chasing Yield In A Low-Interest-Rate Environment

Interest rates remain at or near record lows, which fans the temptation to seek the highest-yielding investment strategies and securities. “Investors need to be careful because higher yields tend to be associated with higher risk,” says Andrew Willms, president and chief executive officer of The Milwaukee Company, a wealth management firm in Thiensville, Wisconsin.

The risk is especially relevant for bonds these days. The benchmark 10-year Treasury Note is currently yielding around 0.7% (as of June 15, 2020). That’s close to a record low.

“Many investors, particularly retirees who rely on income generated by their portfolios for living expenses, are frustrated with such low yields,” Willms notes. “The emotional response is to search for bigger payouts to compensate. But this where the danger lurks.”

For example, so-called high-yield bond funds (funds that hold fixed-income securities that are rated below investment-grade) are posting trailing yields of roughly 5%-plus. On first glance, these look tempting, but there are caveats to consider.

“Bonds offering higher yields aren’t a free lunch,” says Willms. “There’s a reason why the market prices so-called junk bonds with more-tempting payouts: there’s greater risk.”

Default rates for high-yield bonds are substantially greater compared with investment-grade corporates, he notes. Government bonds, of course, have zero default risk.

In addition, high-yield bonds are subject to much greater price volatility. “As a general rule, it’s wise to think of high-yield bonds as akin to stocks,” he says.

“Keep in mind, too, that the trailing yields reported for all bond funds reflect the past. As a result, the yield you receive in the future can be significantly different, depending on market conditions in the months and years ahead,” Willms advises.

Junk bonds and other corners of the bond market can play a productive role in a broadly diversified investment portfolio, he explains. The caveat is that each investor should customize the asset allocation of their portfolio to reflect his specific risk tolerance, investment horizon, expectations and other factors. In other words, higher-yield bonds may or may not be appropriate, depending on the investor.

“Even when high-yield bonds are used in an investment strategy, there’s the critical question: How big of a role should these securities play in the portfolio?”

There are no simple answers because every investor is different. For most investors, the solution is to work a knowledgeable financial adviser to build a prudent portfolio.

“There are no short cuts for successful investing, but there are tried-and-true strategies for building wealth,” Willms says. “One of the key rules these days: Don’t mindlessly chase yield.”

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About The Milwaukee Company
The Milwaukee Company (TMC) is a wealth management firm based in Thiensville, Wisconsin. TMC offers investment-related services to individuals, trusts, investment entities, and charitable organizations. The company also provides insights and advice on how to reduce income taxes on investment portfolios, as well as plans to successfully transfer wealth to family members and charitable organizations. For additional information, visit: themilwaukeecompany.com