Don't fear the (rates) reaper
Three rising rates considerations for fixed income investors

SLC Management

#1 - If time horizon > portfolio duration, then the portfolio can benefit from higher rates

- Reinvesting income at higher yields and the power of compounding over the investors time horizon can outweigh the immediate price decline that occurs when rates rise

- If an investors time horizon is shorter than the duration of their portfolio, they are primarily exposed to price risk, so rising rates hurt. However, if the horizon is longer than the duration, they're more exposed to reinvestment risk and higher rates are a positive

- On the right, we shock a portfolio with a 200 bps rate rise. After 1.8 years (the duration of the portfolio) the rate rise can prove beneficial to the investor.

#2 – Breakeven yield – how much can rates rise before 1-year portfolio returns are negative? (i.e. price decline outweighs yield)

- In the front-end of the curve, where the effects of rate movements are muted by lower durations, yield matters

- For example, the first table on the right shows a short duration portfolio and how front end carry (yield advantage) can help to ensure a strong positive return when rates rise 100 bps

- The second table calculates the "breakevens" for a short duration portfolio with a yield advantage and the Index. The portfolio can withstand a 284 bps rate rise before total return is zero versus the index which can only sustain a 180 bps rise.

#3 - Active management can help offset the impact of rate movements

- In shorter duration portfolios, active management focused on outyielding the index and building portfolios that mitigate yield volatility will help weather the storm of rising rates

- Managers can introduce tools such as floating rate debt, this typically outperforms in a rising rate environment. Similarly, securitized bonds that pay frequent coupons can allow the manager to invest more quickly into rising rates, enhancing the benefits of reinvestment

- In a rising rate environment the duration of both a portfolio and its index will typically shorten (measured by convexity), which helps to reduce interest rate sensitivity. Building portfolios where the duration shortens more rapidly than the index (higher convexity) can help managers to outperform their benchmarks.

Example - Rising rates can be beneficial for investors with time horizons greater than portfolio duration
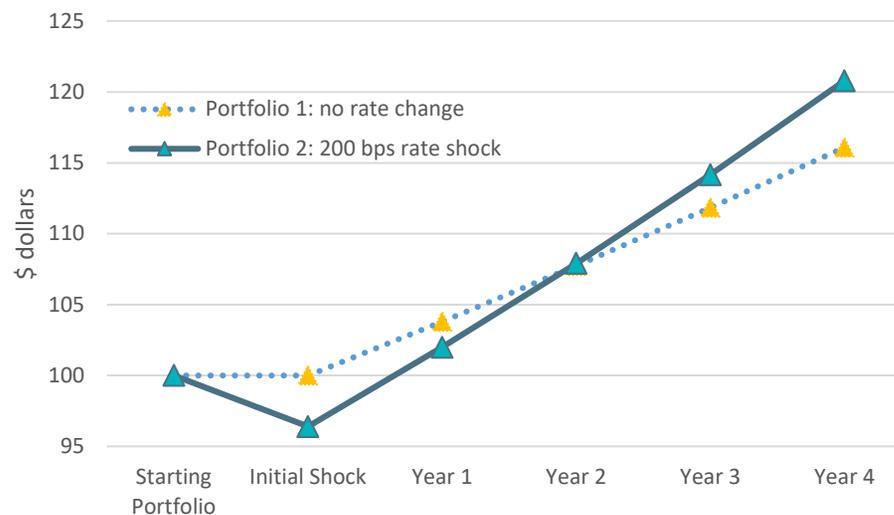
Short duration portfolios can withstand significant rate rises and still earn positive returns

+100bps rate shock – 1 year time horizon (Illustrative scenario)							
	duration	price return	starting yield	additional income*	1yr income return	1yr total return	avg. credit quality
Example Short duration portfolio	1.8	-1.8%	3.8%	0.5%	4.3%	2.5%	A+/A

*As yields rise, additional income above the starting yield can be earned throughout the year

Illustrative return scenario - 1 year time horizon, breakeven rate increase					
	Breakeven yield shock	1 year price return	1 year income return	1yr total return	avg. credit quality
Example Short duration portfolio	+284bps	-5.2%	5.2%	0.0%	A+/A
Bloomberg G/C 1-3	+180bps	-3.3%	3.3%	0.0%	AA/AA-

Duration and starting yield figures are based on market conditions in Q1-2022. This is not necessarily representative of an actual portfolio. For illustrative purposes only. Average credit quality based on S&P ratings. There are important disclosures that are integral to this presentation and are located on the following page.

Disclosures