11 REASONS WHY CONTINUING TO HOLD BONDS MAKES SENSE by Jeff Herold

Jeff Herold is Vice President and Director at J. Zechner Associates. His view is that during times of economic stress, investors are attracted to bonds for their relative stability, regular income, and role in asset diversification.

In light of his investing experience spanning several market cycles, we have asked Jeff to provide his thoughts on the important role fixed income can play in any market.

1 **DIVERSIFICATION IS ALWAYS IMPORTANT.** Equity bear markets are difficult to foresee, except in hindsight. Bonds offer capital protection when equity values are falling.

2 **MANY ASSETS ARE AFFECTED BY RATE INCREASES.** Other asset classes are not cheap and may be affected more than bonds by reductions in monetary stimulus. Equity multiples, real estate values, and loan default rates are all at risk in the event of higher rates.

3 **CREDIT QUALITY IS NOT TO BE TAKEN LIGHTLY.** Alternative products can appear to offer better yields than Canadian investment grade bonds, but often entail substantial credit-worthiness and foreign exchange risks. Investors who chased yields and ignored risks suffered substantial losses in the sub-prime meltdown of the recent financial crisis.

4 **THE RISK OF BOND LOSSES IS POORLY UNDERSTOOD AND OVERSTATED.** Last year, the yield of 10-year Canada bonds rose almost 1.00%. The Canadian bond market fell only 1.19%. Compare that to the 33% loss on stocks in 2008.*

5 **INCOME SOLUTIONS ARE NEEDED LONG TERM.** The Baby Boomer generation is starting to retire and that is increasing demand for income-producing assets such as bonds. That trend will last for years.

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Jeff is Vice President and Director at J. Zechner Associates where he has led the fixed income team for 15 years. With over 35 years of experience, Jeff plays an important role with NexGen managing the Cash and Canadian Preferred Share Funds, as well as the fixed income portions of the Balanced Growth, Turtle Balanced, and Diversified Income Funds.

6 **THE REAL PROGNOSIS FOR BONDS IS NOT DIRE.** Pension funds are shifting their asset allocations to bonds following strong equity returns in 2013. The shift toward bonds will help lock in the improved (i.e. reduced) values of liabilities due to higher discount rates. This asset mix shift will be supportive of bond valuations.

7 **THE VAST SUPPLY OF NEW ISSUES WILL NOT LAST FOREVER.** Government bond issuance is falling as budget deficits are eliminated. Less supply is supportive of bond valuations.

8 **THE BOND BEAR MARKET IS ALREADY REFLECTED IN PRICES.** The increase in bond yields going forward is unlikely to be as much as occurred in 2013. The yield curve is very steep, as long term yields are much higher than short term yields. Long term bonds are already anticipating higher interest rates that may or may not actually occur.

9 **FEDERAL BANKING POLICY CAN SHIFT WITH ECONOMIC NEWS.**
The Bank of Canada is unlikely to raise interest rates in 2014, given the Bank's concern about low inflation and the slack in the Canadian economy. On the other hand, if the Bank cuts interest rates, bond prices should rally.

10 **INFLATION IS LOW.**
That means bonds are producing positive real returns.

11 **THERE IS VALUE IN HIGH QUALITY BONDS.**
The rise in yields last year makes investment grade bonds even better value in 2014.

* Sources: S&P / TSX Composite – Bloomberg, DEX Bond Universe – PCBond.

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