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# Bonds, With Stocks, Help Investors Strike a Balance

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It's in times of panic that we make deals. Please, God, let me live and I'll never eat red meat or Twinkies again. So, it should come as no surprise that investors saving for retirement are promising to reform after double-digit stock returns transformed into double-digit losses. Even if that means holding their noses and adding bonds to their diet.

The question is: Are investors sincere?

That's impossible to say, but "it's the only time people will listen," said Randy Merk, chief investment officer with American Century Investments in Mountain View. Bonds, which are essentially government and business IOUs that pay interest regularly, have always deserved a place in most portfolios. But with retirement years away, many in this generation of bullish investors have rejected bonds, believing they are appropriate only for those who are retired or need a stable "fixed" income.

Financial advisers see the stock market's collapse as a reason for stock-minded investors to rethink their disdain for bonds. Though bonds will hold back a fast-revving stock portfolio most years, they also act as shock absorbers to cushion investors from the stock market's jarring ride. You buy bonds for security, not to maximize your returns. They diversify your portfolio, bolstering your courage to keep your foot on the accelerator even when the stock market seems to dead end. In short, bonds can make you a more confident stock investor.

"Who wouldn't go crazy if they saw their \$200,000 nest egg go down to 75 grand?" said Stan Young, president of Financial Clarity in Mountain View.

"What bonds allow you to do is hold onto those volatile tech stocks when they go from \$50 to \$5. If you are forced to sell when things go down, you will never realize the potential of those risky assets."

Investors appear to be receptive to the merits of bonds for the first time in years - but they're not necessarily committing to buy them, experts fear. Nervous

investors drained a record \$20.6 billion from stock mutual funds in March -- six times the \$3.3 billion net outflow the previous month, according to figures released last week by the Investment Company Institute.

Investors steered nearly \$8 billion of that money into bond funds. But they parked the bulk of it in money-market funds, which eclipsed \$2 trillion in assets for the first time at the end of March.

### **Moving to the sidelines**

That "tells you that instead of reallocating or revising their portfolios, they are just moving to the sidelines," said Christopher Molumphy, a chief investment officer for Franklin Templeton Investments in San Mateo. "The mentality should not be, 'I'm going to have all my money in equities, and then when I get scared I will pull it out and pick a spot to re-enter.' That is not prudent investing."

That impulse is sometimes so strong that financial planners must contort their logic in order to persuade clients to build safer portfolios. If he went by the book, for instance, Palo Alto financial planner Jerry Nightingale typically would recommend devoting a portion of every portfolio to a mixture of bond funds investing in short- and intermediate maturity bonds and mortgages.

But that's a hard sell for some of his stock-minded clients who are years from retirement. Sometimes, it's all he can do to persuade them to plunk some money into high-yielding money-market funds. Those actually are "cash" instruments, but they can buffer a portfolio somewhat like bonds.

To bring his clients around, Nightingale plays on their stock-buying instincts. "I say, 'If you have everything in stock, then what are you going to do when the stock market goes down? What are you going to use to take advantage of buying low?'"

Then again, many investors have gone to the other extreme as the stock market tanked. They've lost their confidence in stocks altogether. Ironically, the result is the same: They're forsaking bonds. "They're saying, 'I'm scared, really scared. Put all my money in a CD,'" said Barbara L. Steinmetz, a Burlingame financial planner. "That is a knee-jerk reaction to getting burned, and that is way on the side of conservatism."

### **A new philosophy**

Though these emotions are natural and understandable, they nonetheless expose investors to unnecessary risks. A stock-only portfolio will be hammered in bear markets. A cash-heavy portfolio will be whittled away by inflation.

The middle ground is a diversified portfolio with an appropriate chunk devoted to bonds. That percentage will vary depending upon such factors as your age and tolerance for risk, with a number of software and online tools available to help you find the right mix. But identifying the right mix isn't the only change required. Many investors must adopt an entirely new investment philosophy -- one based on diversification, not profits.

But it won't work if you lack the discipline to accept lower returns when stocks are zooming.

``It's sort of like Weight Watchers," Steinmetz said. ``They don't teach you to eat for the diet. They teach you to eat for a lifetime."

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