# Locking in 'Real' Losses

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You probably know that the 'real' return of an investment is the gains and income you receive minus inflation and taxes. Most of us invest with the idea that, over time, we will experience positive real returns.

One would imagine that the cadres of bond investors have that same expectation, but the current situation is somewhat befuddling. Today, twelve-month Treasury bonds are yielding 3.10%. If you factor in the roughly 9% current inflation rate, that suggests that short-term bond holders are willing to experience 'real' returns of negative six percentage points over the coming year. Twelve-month Treasuries are actually generating a lower yield—currently 2.92%. Even if inflation comes down from its current rate over the next decade, it is not hard to project a negative 'real' return from that investment.

An investor in 1-year municipal bonds would currently receive, on average, a yield of 1.47%, which projects to an even greater negative yield.

What gives? There are a variety of factors at work here, including the fact that bonds tend to act as the portfolio's ballast during market downturns, which makes them valuable in unstable times. They provide a steady income and rarely fall to the same degree as more volatile assets do during bear markets. If you hold a bond to maturity, you receive a predictable yield and, with high-quality bonds, you get your money back at the end. You won't get that kind of guarantee from stocks.

In addition, an allocation to bond or bond funds offers a pool of assets that could be used to buy stocks if/when prices become attractive—in the meantime collecting interest that can be used for the same purpose.

And for a person in or nearing retirement, having one to three years in a stable investment means that you will be able to meet your cost-of-living needs without having to sell stocks in the portfolio during a market downturn—which is one way of avoiding the danger of locking in losses and compromising the ability to sustain a retirement lifestyle going forward.

Institutions buy bonds for a different reason. Insurance companies must ensure that they will have the assets to pay out projected death benefits, which means they tend to buy low-risk investments. The same is true of pension funds; buying bonds can allow them to match their future income with future payouts to beneficiaries.

So, yes, locking in a 'real' loss seems counterintuitive. Nobody would recommend that somebody do this with their entire retirement portfolio. But bonds will always, in every scenario, have a place in peoples' portfolios. And if history is any indication, eventually, one hopes sooner rather than later, bond yields will once again outpace inflation, and we can all get back to earning a 'real' return on that part of our investments.

**Sources**:

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**Jeffrey Broadhurst**
MBA, CFA, CFP
Broadhurst Financial Advisors, Inc.

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**Our physical and mail address**:
1911 West Point Pike
P.O. Box 301
West Point, PA 19486-0301

**Contact us**:
Phone: (215) 325-1595
Email: jeff@broadhurstfinancial.com