The Thing About Junk Bonds - Transcript

Tim Mullooly: In episode 96, we're going to talk about junk bonds.

Welcome to the Mullooly Asset Show. I'm your host for today, Tim Mullooly. This is episode number 96. Brendan, let's get right into the question for today. What are we going to be talking about?

Brendan: I've heard that junk bonds are performing pretty well this year. Should I switch my bond allocation over to some junk bonds?

Tim Mullooly: We've been hearing about junk bonds quite a bit in the headlines, and bonds in general this year. One article in particular that I happened to read was on the Wall Street Journal recently. It was talking about how junk bonds are outdoing their peers this year, which is true in terms of performance. Junk bonds are performing better than other types of bonds this year.

But the article went on to say that it's a somewhat dismal year for bonds. I guess that depends on your definition of the word dismal. I looked it up. AGG, which is the aggregate bond index, is down 1.75% on the year. Again, it depends on how you define dismal, but not really all that bad in terms of percentage, what you lost, if you have AGG this year.

Our friends at Ritholtz Wealth Management, Josh Brown and Michael Batnick, sometimes say that a bad year for bonds is a bad afternoon for stocks. Keep that in mind when you look at your bond allocation. Down 1.75% in AGG could happen easily in an ETF of stocks, different equity investments, in an afternoon or a couple days, or even a couple hours.

You're going to see more volatile swings in stocks than you are in bonds, but that's why you own bonds. I guess you could say, and it's true, junk bonds are performing better than an aggregate bond index, but it works back to the question of what do you want your bond allocation to do?

You're not buying, in most cases, you shouldn't be buying your bond allocation for growth. That's what the stock allocation is for in your portfolio. You're buying the bonds as a behavioral anchor to soften the blow when stocks do go down because bonds will be there to maintain their value because a dismal year for them is only down 1.75% so far this year. They don't go down as much as stocks do, or they don't go down at the same times, so you want to have things that balance each other out.

So yeah, you could own junk bonds this year and you would be performing a little bit better, but that's not ultimately why you're owning bonds in the first place. If you want to buy junk bonds for the performance, I would tell you to just go buy the stocks. You'll probably end up getting better performance from the stocks, and you can have a bond aggregate index, like AGG or some other type of aggregate bond fund, to really serve as the true bond allocation in your portfolio that is safer, more conservative in nature, and keeps a cushion for the volatility that you're going to find in stocks.

So yes, junk bonds are performing better this year, but ultimately that might not be the reason why you own bonds in the first place. Just keep that in mind when you're evaluating your bond allocation this year and you see the dismal performance that they have. That's going to do it for episode 96 of The Mullooly Asset Show. Thanks for watching. We'll see you on episode 97.