FIXED INCOME ETFs -- $250 BILLION REASONS TO GET IN

BY PETER TCHIR

PETER TCHIR'S FIXED INCOME REPORT

The fixed income ETF space has shown incredible growth in recent years, hitting over $250 billion in assets as investors both big and small embrace the unique advantages of these instruments.

In fact, major institutions like the $50 billion Virginia Retirement System and the $17 billion Stanford University endowment now invest in fixed income ETFs, according to an October 2012 report from industry publication *Pensions & Investments.*

And did you know that the world's largest mutual fund (of any kind, not just bonds), the PIMCO Total Return Fund, managed by the legendary Bill Gross, now has an ETF equivalent trading under the ticker **BOND?**

Now, there were some juicy headlines about BOND outperforming the mutual fund (mostly because of the ETF's smaller size, which allowed Mr. Gross greater trading flexibility), but we'd like to make two points:

1. The ETF has a much lower expense ratio -- PIMCO Total Return A shares have an annual expense ratio of 0.85%, while the BOND ETF's is just 0.55%.

2. The ETF has no upfront sales charges (aside from standard brokerage commissions, which are extremely cheap).

This is very common. You'll find that ETFs are almost always cheaper to own than equivalent mutual funds.

According to the Investment Company Institute, in 2011, the average expense ratio for a bond mutual fund was 0.62%.

Now let's look at the expense ratios for some of the most popular bond ETFs:

iShares 20+ Year Treasury Bond (TLT): 0.15%
iShares Investment Grade Corporate Bond (LQD): 0.15%
SPDR Barclays TIPS (IPE): 0.18%
SPDR Barclays High Yield Bond (JNK): 0.40%

Now, the BOND ETF is actually attracting more assets than the mutual fund!

According to Bloomberg, the Total Return Fund attracted just $32 million in March 2013, while the BOND ETF grew by $285 million.

As we referenced above, ETFs are incredibly cheap to trade as they carry the same rock-bottom commissions investors get on stocks.

And in some cases, trading is actually free as reputable brokerage firms like TD Ameritrade, E*Trade, and Fidelity offer commission-free trading on certain ETFs.

Contrast this with many popular bond mutual funds, which can carry expensive upfront sales charges.

For example, the PIMCO Total Return Fund A Shares carry an upfront load of 3.75% – that's a $375 fee on every $10,000 invested.

Meanwhile, you could theoretically buy $1,000,000 of the ETF for $10 through some online brokers.

So is it any surprise that fixed income ETFs – which are dirt-cheap to buy, sell, or hold – are all the rage for investors serious about returns?

ETFs Let You Truly Manage Your Fixed Income Portfolio

Fixed income was once the quintessential buy and hold asset class because of two unfriendly features.

First, due to a lack of liquidity, the cost of trading was high.

And second, because there was no open market for bonds, there was no "official" price. It was not at all unusual to call up six different brokers and get six different prices for the same bond.

Mutual funds, which remain a great way to invest "core" parts of your portfolio, don't encourage rebalancing or opportunistic trading of market opportunities.

They are only priced at the end of the day, so taking advantage of intraday moves is simply not possible. And as we illustrated above, mutual fund trading can be very expensive.

But with ETFs, you can proactively manage your fixed income portfolio throughout the trading day (including before and after the stock market close) with maximum flexibility and minimal (or even zero) costs.

And in terms of breadth, there are large liquid ETFs that cover:

- Treasuries and TIPS
- Municipal Bonds
- High-Yield Bonds
- Investment Grade Bonds
- Leveraged Loans
- Emerging Market Bonds
- Preferred Stocks

And with the boom in the fixed income ETF market, this list is growing rapidly.

As an example, floating rate bond funds are quickly becoming a large market as investors seek an efficient means to manage interest rate exposure. More foreign bond funds are being created and growing. We are also likely to see ETFs that provide access to structured credit markets like CLOs and credit derivatives as the search for yield progresses and investors become more sophisticated.

Why You Should Want to Manage Your Fixed Income Portfolio

While it is obvious that you can manage your fixed income portfolio more aggressively with ETFs, why would anyone want to?

The answer is simple: returns.

At any given time, there are significant opportunities within the fixed income market to create portfolios to suit specific views about growth, housing, inflation, currency movements, etc., And often expressing specific views can be done more optimally in fixed relative to equities. For example, in a low-growth, low-inflation scenario that would be unfriendly to stocks, the **iShares 20+ Year Treasury Bond** (TLT) would likely be a winner.

A rise in short-term interest rates, as we saw in early 2000 and early 1994 (preceding huge declines in equities) could put a dent in the Dow, but the **Powershares Senior Loan Portfolio** (BKLN) or **iShares MSCI Floating Rate Note Fund** (FLOT) would rally.

Think Total Return, Not Just Yield

You don't invest in the 10year treasury at 2% because you necessarily think 2% is a great yield for the next 10 years. You buy t because you think yields are going to 1.85%, giving you 1% in price appreciation while you are receiving interest.

As an example of the power of even modestly increasing investment returns, over a 10-year period, let's take a theoretical one-time $10,000 investment. After 10 years, growing that investment at 2% annually would turn that $10,000 into $12,190.

But if you can earn 4% annually, you'll end up with $14,804 – an increase in return of 120%!

Similarly, sitting out of high yield bonds for a month may seem counterproductive at first. Let's assume that they're yielding 6%. That's only 0.5% a month and by being underweight, you can often avoid negative price moves that would take months of interest returns to offset.

Therefore, since ETFs are giving investors newfound trading flexibility, the smart investor will examine fixed income investing in terms of total return and not just yield. You don't want to ignore carry (the income received by the bond owner), as over time that plays a crucial role in performance, but rate risk, duration, credit risk, currency risk, and policy risk can all create trading opportunities that will enhance the performance of your fixed income allocation.

What About Exotic High-Yield Instruments?

So it's easy to understand that properly trading fixed income ETFs lets you seamlessly and transparently trade a number of markets in ways never before possible. But more importantly, they offer a far better risk/reward than moving into more illiquid, exotic high-yield instruments that carry enormous risks buried in the fine print of a 500 page prospectus.

For example, people generally assume that certificates of deposits are extraordinarily safe instruments. The truth is far, far more nuanced.

For examples, some CDs offer high coupons during the first year, but are callable, with future coupons dependent upon on range accrual calculations (how many days a certain rate stays within a certain range.

Confused yet?

What about CDs tied to inverse floaters, which perform horribly if rates rise? These instruments may appear enticing as simple income vehicles, but there is no easy money out there.

Conclusion

We think we've made a pretty strong case for the investment value of fixed income ETFs, which offer investors maximum flexibility at minimum (or even zero) cost.

Now if you'd like to take your own fixed income profits to the next level, we'd like to invite you to take a free trial to *Peter Tchir's Fixed Income Report,* which will give you access to the following:

- Peter's exclusive fixed income ETF portfolio strategies for conservative, moderate, and aggressive investors.
- Expert analysis from a pro who traded over $1 trillion in fixed income securities for major investment banks like UBS.
- Breakdowns of key market-moving events like major bond issues, economic data releases, and central bank actions.

It's obvious that investors are challenged in generating income in today's low interest rate world, and that the prospect of a possible bubble in the bond market serves as a dark cloud overhead.

However, smart portfolio management and an expert's view of the world will allow the savvy, forward-looking investor to thrive in the new normal of our global economy.

That's why we teamed up with seasoned and respected trader Peter Tchir to create this all-new subscription product, which utilizes low-cost, high-efficiency ETFs to construct portfolios that not only maximize returns, but are built to last.

In fact, we're so impressed with Peter's work that we're going to give you a free trial to his *Fixed Income Report*.

Why? Because we're confident that once you try this modern guide to the world's most important market (the bond market), you'll want to be a customer for life. It really is that simple.

So if you want to be in the know when it comes to fixed income, then you owe it to yourself to take advantage of this special offer.

If you require any additional information on *Peter Tchir's Fixed Income Report*, including product samples and information on bulk subscription licenses, please call us at 1-888-489-4880.