Now may be the time to use bonds in portfolios

- Amid growing fears of a recession, it may make sense to revisit adding more bonds to your investment portfolio, some financial advisors say.
- The yield from a short-term bond portfolio currently can beat the rate of inflation.
- The loss of income-tax deductions, a benign Fed interest-rate policy and credit-worthy issuers nationwide make it a good time to buy munis, according to Ian M. Weinberg, CFP, CEO of Family Wealth & Pension Management.

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Is now the time to revisit bonds in your portfolio?

It may be, given that the Federal Reserve is advocating a "patient" approach to interest rates and a survey by the National Association for Business Economics has found that

about 50 percent of U.S. business economists believe the country will be in a recession by the end of 2020.

Yes, said certified financial planner Douglas Kobak, CEO of Main Line Group Wealth Management. Other factors working against rising rates, he said, are slowing global economic expansion, increasing U.S. stock market volatility and uncertainty in Washington in areas such as a U.S./China agreement, immigration, the national debt, lack of bipartisan support, etc.

The yield from a short-term bond portfolio currently can beat the rate of inflation, he said.

"The right portfolio can add more safety, since individual bonds have a stated maturity date when compared to a mutual fund," Kobak said. "Investment-grade and government bonds also have a low correlation to the stock markets, which can lower the volatility within a portfolio.

"Bond funds and most fixed-income ETFs do not have set maturity dates," he added. "Therefore, in a rising interest-rate environment, there is no set date in the future when an investor will get his principal back."

Erika Safran, CFP, founder of Safran Wealth Advisors, said that "it's always time for bonds."

She added: "You just have to know why you are buying them. I find that a lot of the bond avoiders are alternative investments fans. I don't see the value."

Safran added that there should be no fear of the bond market "unless, of course, you're investing on the long end or on low credit."

"There should be no fear if you buy bonds for diversification and income," she said. "Naturally, there is undue risk if you invest for capital appreciation."

Now is a great time to consider incorporating conventional bonds into portfolios, said Brandon W. Garrett, CFP, president of Snow Garrett Wealth Management.

"As the yield curve has flattened over the last year, we have been given a gift in the form of attractive short-term rates," he said.

"Low rates over the past decade have forced more conservative investors into riskier assets," Garrett added. "With higher short-term rates, conservative investors can once again focus on high-quality, shorter-duration bonds as a more meaningful piece of their portfolio without sacrificing much return.

"Conservative clients should now feel comfortable knowing that the 'safe' portion of their portfolio is earning 2 [percent] to 3 percent rather than zero [percent], which should result in less risk drift and ultimately a better investor experience."

"Our clients appreciate the relative certainty and the predictability of the income flows, and the use of bond ladders lessens the worry about calls and the daily volatility of the bond market."- James N. Reardon, chief investment officer of ProActive Capital Management

Furthermore, Garrett said, if rates move, shorter-duration bonds will be less affected than their longer-duration counterparts.

For his part, James N. Reardon, CFP and chief investment officer of ProActive Capital Management, especially likes using bond ladders of higher-grade U.S. corporates, employing real non-callable bonds when practical. He also likes the more passive nature of bond portfolios.

"Our clients appreciate the relative certainty and the predictability of the income flows and the use of bond ladders lessens the worry about calls and the daily volatility of the bond market," he said. "It's great at the end of the year when the client can see some principal returned and the interest distributed or reinvested for their needs."

This is definitely a good time for municipal bonds, said Ian M. Weinberg, CFP, CEO of Family Wealth & Pension Management, citing loss of certain income-tax deductions, a benign interest rate policy by the Fed and very credit-worthy issuers nationwide. Compared to Treasurys, the net yields of munis are much higher because they are not subject to federal, state and local tax, he said, making them a good value at this time when they're giving investors 80 percent or more of Treasury yields.

In contrast, James Shagawat, CFP, president of Windfall Wealth Advisors, said this is not a good time to look at munis. Factors that make them disadvantageous include interest rates at 50-year lows; bond insurance disappearing (6 percent of new issuance has insurance, down from 57 percent in 2005, according to an Alliance Bernstein report); reduced liquidity, especially for small position sizes; and limited available supply.

"Since the financial crisis, municipal bonds have dramatically been changed," he said. "The strategy that worked well has stopped working.

"What was buy-and-hold the bonds until maturity or until they are called can be a costly mistake."

Shagawat said some solutions including analyzing the bonds, selling them before maturity, doing credit research, or using bond mutual funds.

— By Deborah Nason, special to CNBC.com