DEALING WITH THE 'T.I.N.A.' PRINCIPLE

By Don McArthur, CFA® and Scott Colbert, CFA®

Have you heard of T.I.N.A.? The acronym coined by some financial advisors stands for "There Is No Alternative," an asset allocation dilemma investors increasingly find themselves facing when determining the appropriate composition of their portfolios for their investment goals. It's a reference to having a limited amount of opportunities to earn attractive returns across the board on a risk-to-return basis for your capital vs. the stock market. For instance, knowing where to deploy cash when rising interest rates are hurting bond fund performance is a tough call. In this CTC commentary, Senior Investment Strategist and Director of Equity Research Don McArthur, CFA, and Chief Economist Scott Colbert, CFA, introduce us to T.I.N.A., and how long this principle might be a factor in your asset allocation choices.

WHAT'S UP WITH THIS "T.I.N.A."?

T.I.N.A. is an acronym for "There Is No Alternative – (to stocks…that is)". It's the prevailing quandary for many investors seeking income and return. And mostly it's a reference to the miserly return potential in the bond market given today's ultra-low interest rate environment. Investors are used to having opportunities to earn relatively steady, safe returns in income-oriented asset classes; however, these are currently few and far between.

HISTORICALLY, INVESTORS USED MONEY MARKET FUNDS TO SAVE AND EARN A LITTLE. COULD THAT BE AN ALTERNATIVE?

Currently, money market funds are yielding less than 10 basis points (one tenth of a percent) while some banks try to attract money with a "whopping" 25-basis-point (one quarter of a percent) teaser rate. With inflation well above 1% and rising, the real yield on a money market or cash-like savings fund is negative – not an attractive option. The benefit of savings accounts and money market funds in this environment is simply the return of your capital, but nearly zero return on your capital.

BONDS HAVE GIVEN INVESTORS NICE RETURNS OVER THE PAST DECADE, HOW ABOUT FIXED INCOME AS AN ALTERNATIVE TODAY?

The main reason bonds have provided solid 4% to 5% returns in recent memory is that interest rates were declining. It might surprise you the average yield on a 10-year Treasury bond was only 2% the last five years. But it recently declined to below 1% in 2020 as the pandemic took hold. Investors understand they always get the coupon/yield on their bonds. But when interest rates went down, the price of their bonds went up providing additional return in the form of capital appreciation. With a 10-year treasury currently around 1.7%, there isn't much room for bond yields to go much lower. So, at best bond market returns are likely to average 2% to 2.5% over an intermediate time frame (let's say the next five years) versus the 5% you fondly remember. In addition, short-term returns could even turn modestly negative on a calendar year basis if rates continue to climb as they have so far in 2021.

IF INTEREST RATES ARE THIS LOW IS THERE YIELD ANYWHERE ELSE TO PROVIDE INCOME?

Fortunately, the average dividend yield for the S&P 500 is about 1.5%. And, at the end of February, 65% of stocks paid a dividend yield higher than the 10-year treasury. Additionally, many name brand companies have a dividend yields that are nearly double this average and could be a good fit for income-oriented investors. And as has always been the case over longer time periods, we expect the size of dividends paid on the S&P 500 to slowly increase as companies earn more money. Historically, the growth rate of dividends has kept up with inflation, helping stocks earn positive "real returns" for investors willing to commit to the volatility of the equity market. Stocks generally help investors increase their income over time.

WHAT ABOUT STOCKS WITH CONSIDERABLY HIGHER DIVIDENDS OR THE YIELDS AVAILABLE IN THE JUNK BOND MARKET?

To paint many of those investments with a broad brush, the higher the current yield, the riskier they get. And if it seems too enticing to be true, it probably is (too good to be true). A company that pays a considerably higher dividend (right now in excess of 5%) generally has a riskier financial profile or business model that could put the dividend or stock price at risk. In 2020, roughly 60 companies cut or reduced their dividend. We watch the level of dividends companies pay relative to their earnings and relative to their peers to monitor those that may be at risk. As investors search for income alternatives, they are also driven to the high yield/junk bond market with similar 5% plus yields. We spend a lot of effort trying to squeeze income out of our portfolios and often recommend a very small slice of higher yield, but on a one-off basis these products have risks that may not be fully conveyed. We encourage investors to work with a fiduciary advisor like Commerce Trust Company who has their best interest as a guideline to properly vet these products and blend them cautiously and judiciously into your portfolio.

THEN SHOULD INVESTORS SIMPLY GO "ALL IN" ON STOCKS?

A 100% equity portfolio could be appropriate for certain investors who have a long time horizon and who can handle the major fluctuations that naturally occur. We have many of those clients. But, over the last two decades investors have had to stomach three bear markets that drove U.S. stock prices down 50% (when the internet bubble burst), 55% (during the subprime crisis) and 34% last spring (as the coronavirus took hold). At Commerce Trust Company we work with each client to create a customized portfolio to fit their financial needs and risk tolerance.

SO WHAT DOES COMMERCE TRUST GENERALLY RECOMMEND RIGHT NOW IN THIS UNFRIENDLY YIELD ENVIRONMENT?

Simply put….we recommend an overweight to stocks and an underweight to bonds in our managed client portfolios. But we don't recommend clients abandon the bond market entirely. Bonds are still an important insurance policy when or if large-scale instability occurs and offer an extremely high quality nearly guaranteed income stream. As interest rates rise, the reinvestment of all maturities and coupons compounds at those higher rates and over time, offsets potential short-term declines in bond prices. If you are a long-term investor and want your portfolio to absorb the occasional bear market shock from the stock market, fixed income investments like bonds are still perfectly appropriate for a portfolio.

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