Fixed Income Management

KOVITZ INVESTMENT GROUP

Capital Ideas.®

In most years, it is difficult to make distinctions among bond managers. Too often, investors try to find the manager who offers the highest current yield. This often leads managers to take additional risks, extend maturities, or use leverage in hopes of generating a little extra yield to help them stand out from the pack.

Worse yet, many managers try to deter clients from investing in "boring" high-quality bonds because they have a better (usually more expensive) alternative. Generically referred to as fixed income substitutes, they include preferred stocks, asset-backed securities, high dividend paying stocks, and leveraged bond funds. The common denominator is that they offer more income, but are supposedly "safe".

And there are other managers who encourage investors to abandon bonds altogether because they believe they can divide the assets into many different "buckets" (perhaps they call them "style boxes"). They claim that their models can provide adequate diversification without bonds – that these buckets do not move in the same direction at the same time. Put another way, these managers believe they can diversify away the risk without having to invest in those boring old bonds at all.

Warren Buffett has said that "it's not until the tide rolls out that you can tell who is swimming naked." It is safe to say that there were many bond managers who were skinny dipping in 2008. In contrast, we stuck with high quality bonds, did not extend maturities, and avoided asset-backed securities and leverage. As a result the bonds managed at Kovitz Investment Group in Calendar Year 2008 earned over 4% after fees when, according to Lipper and Morningstar, the average bond manager lost money.

The lessons learned in 2008 and the virtues of staying focused on true asset class diversification will remain relevant for years to come. Investors who take this to heart will avoid getting distracted by Wall Street's next fixed income substitute.

If you have more than $500,000 to invest, and would like to talk about how we can customize a bond portfolio to your credit quality, duration, state and tax parameters, please call us at 312-334-7300 or visit our website at www.kovitzinvestment.com.

T 312. 334. 7300 115 South LaSalle Street, 27th Floor, Chicago, IL 60603 info@kovitzinvestment.com www.kovitzinvestment.com