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Stay the Course

EVEN AS BOND MARKETS CHANGE, THE REASONS TO INVEST REMAIN CONSTANT

For long-term savers, rising rates are nothing to fear. Most investors are familiar with the bond “seesaw” showing the inverse relationship between bond prices and interest rates: when one rises, the other falls. But the reality is more nuanced.

Here we highlight four reasons why bonds may be a valuable part of a diversified portfolio across interest rate environments.

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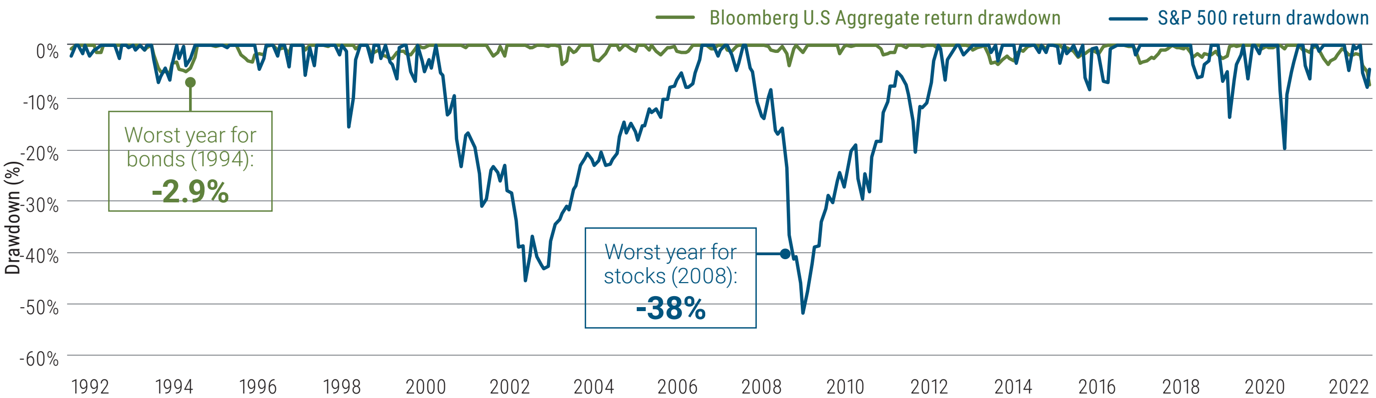
Lower volatility helps preserve capital

Bonds have historically provided capital preservation, income and growth, and diversification – essential goals for many investors – because of their low-to-negative correlations to stocks.

Bonds, particularly core bonds, have been less volatile than stocks. As the chart below shows, bond declines have been dramatically less severe than stocks – and usually short-lived.

A VAST DIFFERENCE IN "WORST CASE" SCENARIOS



Performance quoted represents past performance. **Past performance is not a guarantee or a reliable indicator of future results.**

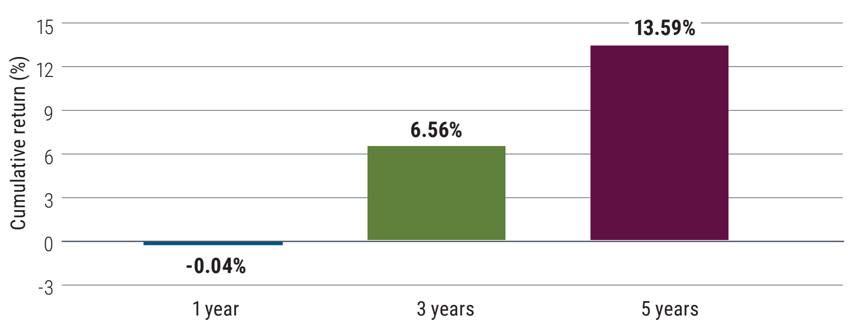
Source: Morningstar Direct. Chart shows U.S. stock and bond declines beginning 31 March 1992 and ending 31 March 2022. Stocks are represented by the S&P 500 Index, bonds by the Bloomberg U.S. Aggregate Index. Worst years are calendar years.

Rising rates build income

Because interest income is the primary driver of bond returns, the ability to reinvest into a gradually rising rate environment can help build long-term growth. When rates rise, new bonds pay a higher coupon, increasing the income investors receive. By contrast, higher rates can be a headwind for stock investors, as increased borrowing costs weigh on corporate profits.

An increase in the income a bond produces also helps to offset the negative impact on its declining price – often quite quickly, as the chart at right shows. Over time, rising income may provide a return advantage for investors.

THE UPSIDE OF RISING RATES



Hypothetical example for illustrative purposes only.

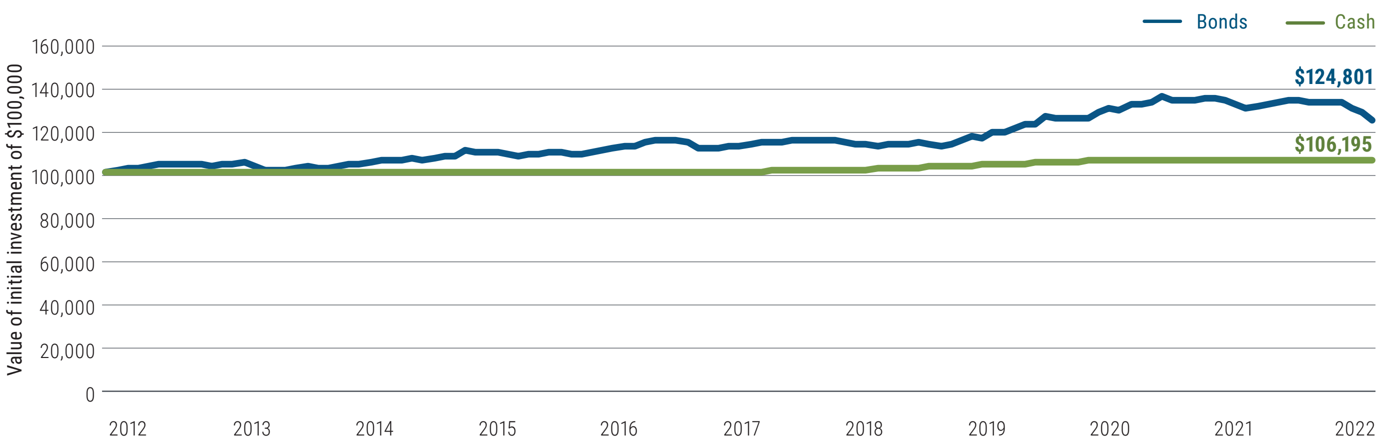
Source: PIMCO, as of 31 March 2022. The chart shows the estimated performance of the Bloomberg U.S. Aggregate Index assuming a parallel rate rise of 0.5%, and no further changes in rates thereafter. Credit spreads are assumed to remain constant. In the analysis contained herein, PIMCO has outlined hypothetical event scenarios which, in theory, would impact the index returns as illustrated in this analysis. No representation is being made that these scenarios are likely to occur or that any portfolio is likely to achieve profits, losses, or results similar to those shown. The scenarios do not represent all possible outcomes and the analysis does not take into account all aspects of risk. Total returns are estimated by re-pricing key rate duration replicating portfolios of par-coupon bonds.

Cash "safety" comes at a price

During periods of market volatility or a rising rate environment, investors may be tempted to exit the bond market into cash and short-term instruments such as money market funds and CDs.

However, investors are almost always better off in bonds versus cash over the long run. Though their prices may fluctuate and there is more volatility and risk, bonds' compounding effect should work to your long-term advantage, as the chart below shows.

A SMOOTH BUT FLAT RIDE FROM CASH...



Hypothetical example for illustrative purposes only.

Source: U.S. bonds – Bloomberg U.S. Aggregate Index; cash – FTSE 3-Month Treasury Bill Index. Chart shows growth of $100,000 from 31 March 2012 to 31 March 2022. Cash is represented by the FTSE 3-Month Treasury Bill Index. Core bonds represented by the Bloomberg U.S. Aggregate Index.

Rising rates don't impact all bonds the same

News about the bond market tends to focus on U.S. Treasuries, which tend to be the most sensitive to rising rates. In reality, the bond market is exceedingly diverse and global, encompassing corporate and high yield bonds, mortgage-backed securities, municipal bonds, emerging market bonds and others. Each sector or asset class responds differently to economic and market trends, and some may even do well in a rising-rate environment.

Although rising rates may temporarily depress the majority of bond prices, skilled active bond managers can find promising investment opportunities in an effort to diversify a portfolio, capture yield and defend against threats to capital.

COMBATING RATE INCREASES IN THE MARKET OF BONDS

Rate hike period	Basis points	U.S. Treasuries	MBS	Investment grade credit	Munis	High yield	Emerging markets
03/29/88 to 02/24/89	325	4.05%	5.39%	5.53%	7.47%	8.07%	n/a
02/04/94 to 02/01/95	300	-2.93%	-0.49%	-3.76%	-3.56%	-1.82%	-22.91%
06/30/99 to 05/16/00	175	2.59%	1.60%	-0.49%	-0.40%	-1.78%	13.70%
06/30/04 to 06/29/06	425	4.90%	6.26%	5.43%	8.97%	15.63%	24.84%
12/15/15 to 12/31/18	225	3.38%	4.77%	9.84%	6.91%	25.88%	15.30%

Past performance is not a guarantee or a reliable indicator of future results. The performance data above is not representative of the performance of any PIMCO product.

Source: ICE BofAML U.S. Treasury Master Index; Bloomberg U.S. Agency Fixed Rate MBS Index; Bloomberg U.S. Credit Index; Bloomberg Municipal Index; Bloomberg U.S. High Yield 1% Issuer Cap Index; JP Morgan GBI Global Ex-U.S. USD Hedged Index; JP Morgan EMBI Global Index (measures external debt). The emerging markets indexes did not exist during the period marked n/a.

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IMPORTANT NOTICE

Please note that the following contains the opinions and views of the firm as of the date noted, and may not have been updated to reflect real time market developments. All opinions are subject to change without notice.

Past performance is not a guarantee or a reliable indicator of future results.

A word about risk: Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and low interest rate environments increase this risk. Reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. **Equities** may decline in value due to both real and perceived general market, economic and industry conditions. Investing in **foreign-denominated and/or -domiciled securities** may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. **High yield, lower-rated securities** involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. Income from **municipal bonds** is exempt from federal income tax and may be subject to state and local taxes and at times the alternative minimum tax. **Mortgage- and asset-backed securities** may be sensitive to changes in interest rates, subject to early repayment risk, and while generally supported by a government, government-agency or private guarantor, there is no assurance that the guarantor will meet its obligations. **Sovereign securities** are generally backed by the issuing government. Obligations of U.S. government agencies and authorities are supported by varying degrees, but are generally not backed by the full faith of the U.S. government. Portfolios that invest in such securities are not guaranteed and will fluctuate in value. **Diversification** does not ensure against loss.

HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM.

ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.

Statements concerning financial market trends are based on current market conditions, which will fluctuate. There is no guarantee that these investment strategies will work under all market conditions or are appropriate for all investors and each investor should evaluate their ability to invest long-term, especially during periods of downturn in the market. Investors should consult their investment professional prior to making an investment decision.

The ICE BofAML U.S. Treasury Index tracks the performance of U.S.-dollar-denominated sovereign debt publicly issued by the U.S. government in its domestic market. Qualifying securities must have at least a one-year remaining term to final maturity, a fixed coupon schedule and a minimum amount outstanding of $1 billion.

The Bloomberg U.S. Agency Index includes native currency agency debentures (Fannie Mae, Freddie Mac and Federal Home Loan Bank), and includes both callable and non-callable agency securities issued by U.S. government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. government.

The Bloomberg U.S. Credit Index is an unmanaged index comprising publicly issued U.S. corporate and specified non-U.S. debentures and secured notes that meet the specified maturity, liquidity and quality requirements. To qualify, bonds must be Securities and Exchange Commission (SEC) registered.

The Bloomberg Municipal Bond Index consists of a broad selection of investment grade general obligation and revenue bonds with maturities ranging from one year to 30 years. It is an unmanaged index representative of the tax-exempt bond market. The index is made up of all investment grade municipal bonds issued after 31 December 1990 that have a remaining maturity of at least one year.

The Bloomberg U.S. Aggregate Index represents securities that are SEC-registered, taxable and dollar-denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities. These major sectors are subdivided into more specific indexes that are calculated and reported on a regular basis.

The S&P 500 Index is an unmanaged market index generally considered representative of the stock market as a whole. The index focuses on the large-cap segment of the U.S. equities market.

The JPMorgan Emerging Markets Bond Index–Global is an unmanaged index that tracks the total return of U.S.-dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities: Brady Bonds, loans, Eurobonds and local market instruments.

The Bloomberg High Yield Index is an unmanaged market-weighted index including only SEC-registered and 144(a) securities with fixed (non-variable) coupons. All bonds must have an outstanding principal of $100 million or greater, a remaining maturity of at least one year, a rating of below investment grade and a U.S. dollar denomination.

It is not possible to invest directly in an unmanaged index.

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