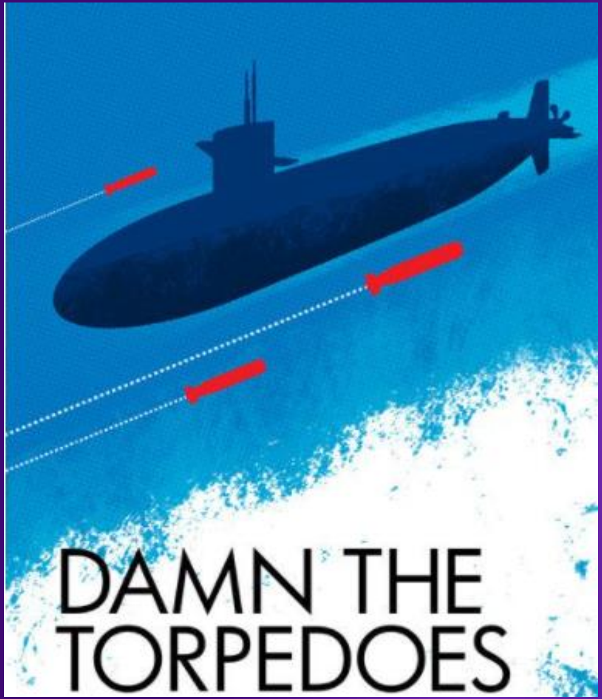

...Inflation Ahead

Bonds As Ballast To Your Portfolio

2022 Presentation for AAII San Diego

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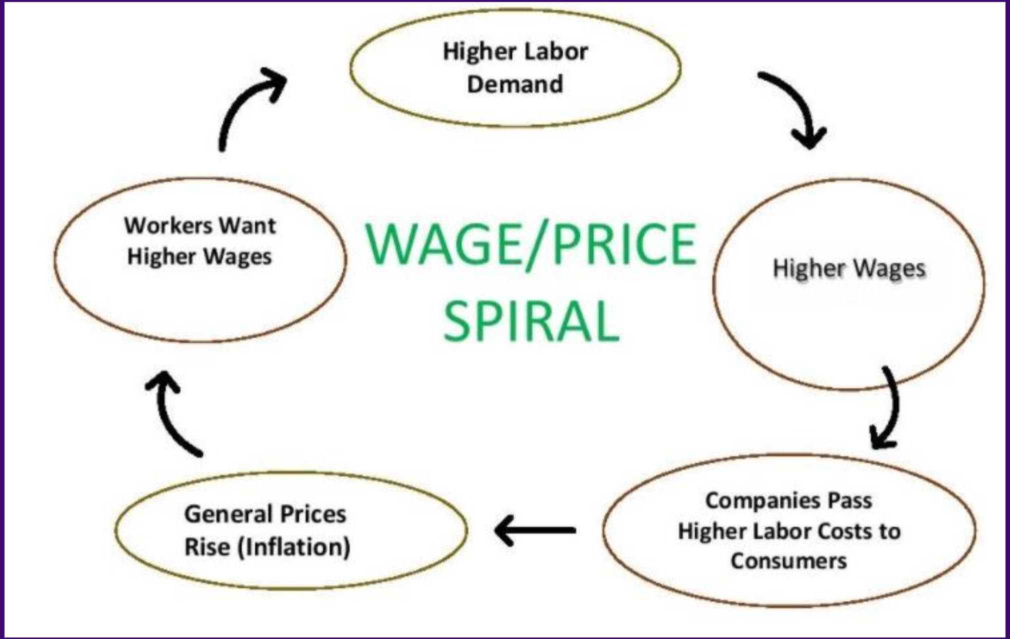
Inflation Continues To Worsen



There's a whole generation –maybe two–that have never dealt with a wage/price spiral

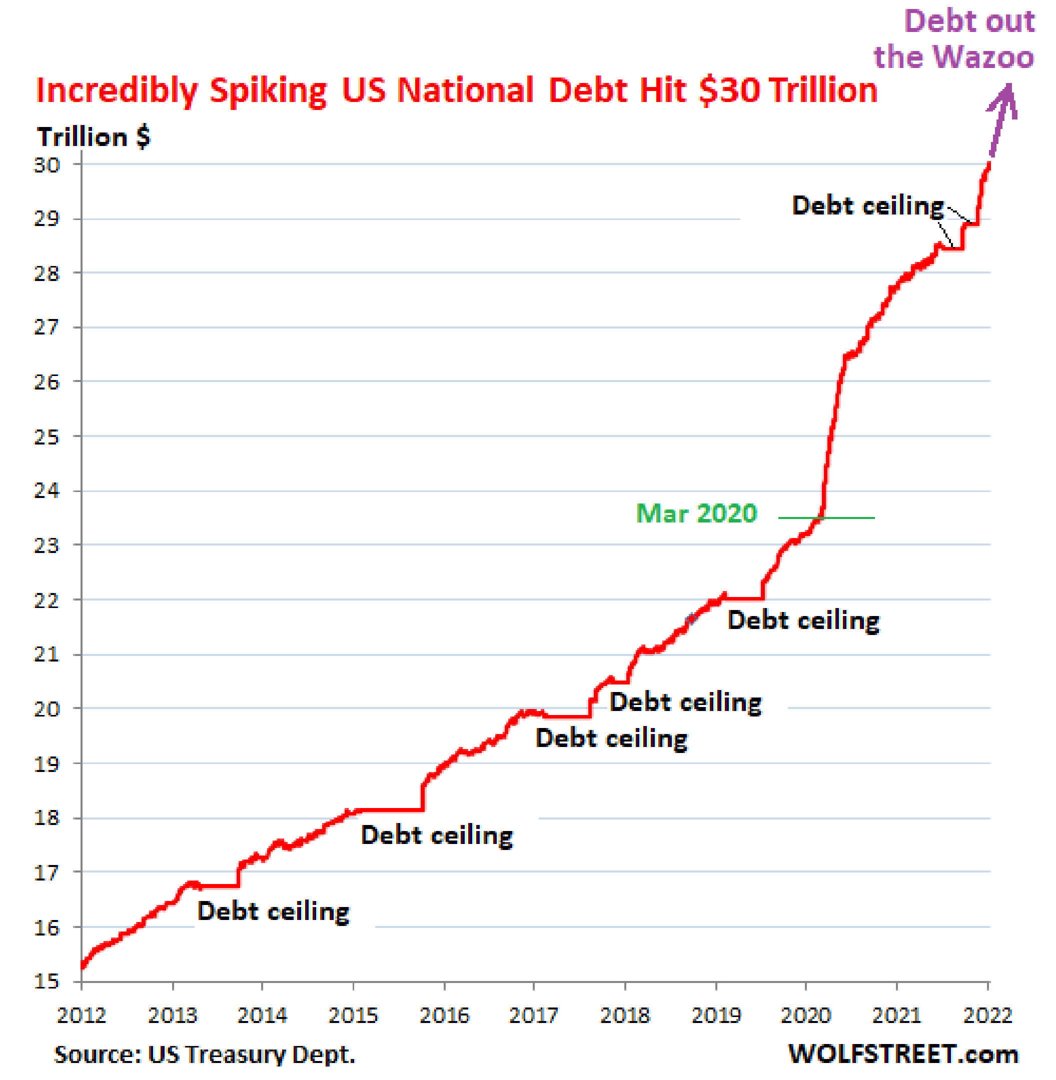
The cost of everything continues to increase due to:

- Energy/fuel
- Transportation, shortage of drivers
- Materials, packaging, input costs of all kinds
- Labor shortages including nurses, workers at plants, teachers, hospitality
- Food

Some other consequences we are dealing with:

- \$4.7 trillion in new money the Fed threw at the financial markets
- \$6.6 trillion the government borrowed and indiscriminately handed out
- Forbearance programs
- Eviction bans with no consequences

All in just 22 months!!


Debt out the Wazoo
Incredibly Spiking US National Debt Hit $30 Trillion
Trillion $
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16
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Debt ceiling
Mar 2020
Debt ceiling
Debt ceiling
Debt ceiling
Debt ceiling
Debt ceiling
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
Source: US Treasury Dept.
WOLFSTREET.com

Our incredible shrinking purchasing power

Chairman Powell should have given the bond market a Volker-type shock—raising rates at least 1% to quell inflation. Until the Ukrainian war dealt the Fed a curve ball.

Bonds Have A Far Greater Potential Return Than Cash

Yields:

- Money markets: .01%
- 3-month T-bills: .65%
- 2-year corporate bonds: 3.12% for BBB rated
- 5-year corporate bonds: 3.45% for BBB rated
- 10-year corporate bonds: 4.25% for BBB rated

The tide has turned—there are very few negative yielding bonds left.

Fixed income: Provides reasonable diversification, a stable source of income, and ballast to your equities.

Yields are quoted mid-day as of April 5, 2022

Treasury Inflation-protected Securities (TIPS)

TIPS provide protection against inflation. The principal of a TIPS increases with inflation and decreases with deflation, as measured by the Consumer Price Index. When a TIPS matures, you are paid the adjusted principal or original principal, whichever is greater. TIPS pay interest twice a year, at a fixed rate. The rate is applied to the adjusted principal; so, like the principal, interest payments rise with inflation and fall with deflation.

iShares TIPS ETF: TIP fee: .19%
Vanguard Short Term TIPS: VTIP fee: .05%

Do you want short or long term? Pick an ETF or Mutual Fund with the lowest fee.

How TIPS Work

Year	Coupon	Inflation	Principal	Interest Paid
1	3%	0%	1,000	30.00
2	3%	10%	1,100	33.00
3	3%	-2%	1,078	32.34
4	3%	-5%	1,024	30.72
5	3%	25%	1,280	38.40

In year 1, there was no inflation and the bond paid a total of $30 for the year. In the following year, inflation increased 10%. The principal of the TIPS increased by 10% as well to $1,100 and the 3% coupon is applied to the increased principal amount resulting in a payment of $33 for year 2. In years 3 and 4, there was deflation and the principal of the TIPS was reduced resulting in a lower interest payment. In year 5, inflation increased again increasing the principal and the interest payment. At maturity, the investor would receive the inflation-adjusted principal amount of $1,280.

Duration Is…

…a measure of the sensitivity of bond prices to a change in interest rates.

If your time horizon is longer than the duration of your bond portfolio or bond fund, you benefit from rising rates.

How? By reinvesting your coupons at higher rates vs. short term appreciation (which most investors don't take)

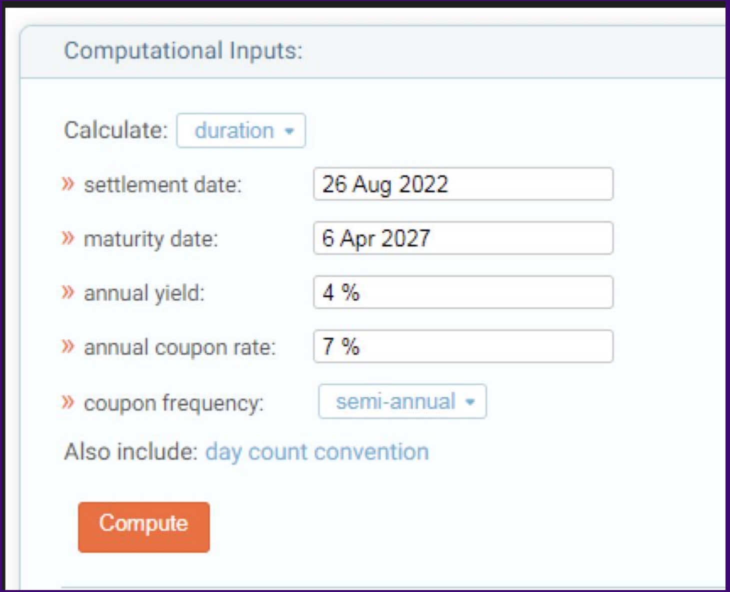
Bond portfolio: 3.25 years duration
Time frame: 8-10 years

Reinvestment of coupons & maturities in a rising rate market is the secret sauce

Here’s The Duration Equation…

$$\text{Duration Formula} = \frac{\sum_{i}^{n-1} \frac{i \times C}{(1+r)^{i}} + \frac{n \times M}{(1+r)^{n}}}{\sum_{i}^{n-1} \frac{C_i}{(1+r)^{i}} + \frac{M}{(1+r)^{n}}}$$

Go to Wolframalpha.com for the Bond Duration calculation



bond duration	
settlement date	Friday, August 26, 2022
maturity date	Tuesday, April 6, 2027
annual yield	4%
annual coupon rate	7%
coupon frequency	semi-annual

Results

duration	3.965
convexity	0.1861 yr/% (years per percent)

Data Points

August 4, 2020	10 year Treasury yield	0.52% (history's lowest)
December 31, 2021	10 year Treasury yield	1.93%
April 5, 2022	10 year Treasury yield	2.55%

Between December 31, 2021 and April 5, 2022 the yield on 2-year Treasurys went from .739% to 2.50% as of 4/5/22

MORE THAN TRIPLED!!

Barbell Strategy

- Microchip Technology, CUSIP: 595017AZ7, 2.67%, due 9-1-23, 2.75% YTM, non-callable
- Reliance Steel, CUSIP: 759509AE2
4.50% due 4-15-23
2.70% YTW to 1-15-23 call, 3.11% YTM
- Fluor Corp., CUSIP: 343412AC6
3.50% due 12-15-24
3.47% YTW and YTM
- Williams Companies, CUSIP: 96950FAM6, 4.30% due 3-14-24
3.13% YTW to 12-4-23 call, 3.28% YTM

- VMWARE, Inc., CUSIP: 928563AC9, 3.90% due 8-21-27
3.82% YTW & YTM
- Broadcom, CUSIP: 11134LAR0
3.50% due 1-15-28
4.00% YTW & YTM
- Willis North American, CUSIP: 970648AG6, 4.50% due 9-15-28
4.20% YTW to 6-15-28 call, 4.20% YTM
- Valero Energy, CUSIP: 91913YAW0
4.00% due 4-1-29
3.85% YTW and YTM

Alternatively

Vanguard short term bond ETF
VCSH yields 1.64%

Vanguard intermediate bond ETF
VCIT yields 2.50%

Yields are quoted mid-day
as of April 5, 2022

Fix-To-Float Variable Rate Corporate Bonds

Western Alliance: Full service bank in AZ, NV, & CA
5.25% due June 1, 2030
CUSIP: 95763PEF4
Moody's: Baa2 Subordinated debt

Western Alliance: 5.25% coupon until June 1, 2025 then it floats at 5.12% *plus* SOFR rate *paid quarterly*.

The static number is the bullseye for you.

- You do not want a cap
- You want the variable portion to be in excess of a minimum of 100bp (1.00% over SOFR (the benchmark index)

Fix-to-float bonds are almost always issued by a financial institution—either a bank, insurance company, or a brokerage firm.

Invest In Preferred Stocks

Positive points

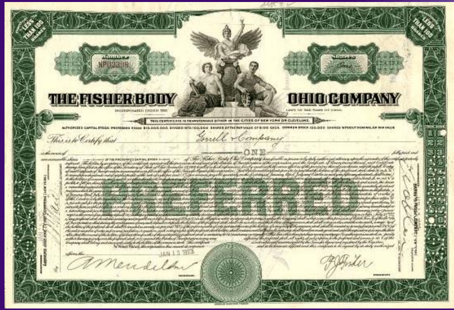
- More liquidity than traditional bonds
- More protection than common stocks
- The issuer cannot cut preferred dividends unless disaster strikes

Negative points

- Many are perpetual
- Some have negative Yield To Calls
- If interest rates go up “a lot” Preferreds act as a long-term bond and get nuked
- Cannot calculate their duration

Preferreds we’ve invested in

• Bank of America	5.00%
• Brighthouse Financial	6.75%
• Wells Fargo	4.375%
• Morgan Stanley	4.875%
• Allstate	5.10%
• Met Life	4.75%
• Capital One	4.80%



Let's Talk Municipal Bonds

Tax induced selling or when municipal credit is in peril such as credit crisis, 2020 Pandemic: Both created major municipal bond fund outflows.

The best time to buy munis is in a panic.

Major peril the municipal bond market faces right now is the shift to a percentage of permanent work at home rather than work at office:

- Loss of commuters for MTA, BART, and other mass transit operators
- Gas tax declines
- Sales tax on lunches and other at-office purchases decline
- Parking fees
- Commercial property tax revenue declines
- Out–migration from broken down cities
- Confiscatory state tax
- Unfunded pensions

If You Invest In Municipal Bonds…

Learn how to properly buy and sell them

Use www.emma.msrb.org as your one-stop municipal bond encyclopedia

- Get a frame of reference for bond yields and prices
- Read the latest financial statement:
  - Do revenues exceed expenses?
  - Does the issuer hold sufficient cash?
  - Are the financials current and consistent with prior years?
  - Is there a secondary source of repayment such as insurance, state aid, state intercept, or prerefunded?
- Think what can go wrong
  - California fires
  - Gulf cities hurricanes and tornadoes
  - Water bonds…California has suffered a 3-year draught
  - Crumbling cities
  - Outmigration

What’s In Store For Us?

- Higher inflation
- 2-5 interest rate hikes as demand destruction creates a recession
- Bear market in stocks continues with wild convulsions
- Yields reach an inflection point (and the yield curve probably inverts)
- Recession occurs = Stagflation
- Then a bond rally: Higher prices and lower yields
- Stock market revives as companies do better

Bottom line: The greater the cash component of your portfolio, the worse hit you’ll suffer from inflation.

Envision Capital Management, Inc.

Fixed Income Money Managers

MINIMUM ACCOUNT SIZE: $500,000

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