SHOULD YOU HAVE BONDS IN YOUR PORTFOLIO?

A Comparison of a 100% Stock Portfolio

and a 60%/40% Stock Portfolio

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Imagine two investors, each with $1 million invested.

The first holds 100% stocks. The second holds 60% stocks and 40% bonds.

Both experience a drop in stocks. Both withdraw a set amount each month.

Now let’s consider 7 scenarios, each with different degrees of stock-market drop and different amounts withdrawn each month.

scenario 1: the stock market drops 10%, and the investors withdraw $3000 a month.

 after 5 years after 10 years after 15 years after 20 years

100% stocks $1,239,203 $1,804,586 $2,734,799 $4,265,255

60%/40% stocks-bonds $1,192,499 $1,579,541 $2,164,806 $3,049,813

scenario 2: the stock market drops 20%, and the investors withdraw $3000 a month.

 after 5 years after 10 years after 15 years after 20 years

100% stocks $1,076,035 $1,536,130 $2,293,114 $3,538,561

60%/40% stocks-bonds $1,102,393 $1,443,287 $1,958,770 $2,738,258

scenario 3: the stock market drops 35%, and the investors withdraw $3000 a month.

 after 5 years after 10 years after 15 years after 20 years

100% stocks $831,283 $1,133,446 $1,630,586 $2,448,521

60%/40% stocks-bonds $967,234 $1,238,907 $1,649,717 $2,270,924

scenario 4: the stock market drops 35%, and the investors withdraw $2000 a month.

 after 5 years after 10 years after 15 years after 20 years

100% stocks $907,719 $1,337,286 $2,044,042 $3,206,850

60%/40% stocks-bonds $1,040,287 $1,423,939 $2,004,078 $2,881,334

scenario 5: the stock market drops 35%, and the investors withdraw $4000 a month.

 after 5 years after 10 years after 15 years after 20 years

100% stocks $754,847 $929,605 $1,217,131 $1,690,191

60%/40% stocks-bonds $894,181 $1,053,876 $1,295,357 $1,660,514

scenario 6: the stock market drops 40%, and the investors withdraw $2000 a month.

 after 5 years after 10 years after 15 years after 20 years

100% stocks $826,135 $1,203,058 $1,823,199 $2,843,503

60%/40% stocks-bonds $995,234 $1,355,812 $1,901,060 $2,725,556

scenario 7: the stock market drops 40%, and the investors withdraw $3000 a month.

 after 5 years after 10 years after 15 years after 20 years

100% stocks $749,699 $999,217 $1,409,744 $1,326,844

60%/40% stocks-bonds $922,181 $1,170,781 $1,546,700 $1,504,736

Conclusions for a 5-year time horizon:

The 60%/40% portfolio beat the 100% portfolio in all scenarios but the first (20% drop and $3000 withdrawals).

If your time horizon is 5 years (you’ll need the money by then), adding bonds is a good idea.

Conclusions for a 10-year time horizon:

The 60%/40% portfolio beat the 100% portfolio in all scenarios but the first two (10% drop or 20% drop and $3000 withdrawals).

If your time horizon is 10 years and you are risk averse, adding bonds is a reasonable idea.

Conclusions for a 15-year time horizon:

The 60%/40% portfolio beat the 100% portfolio in 4 of the 7 scenarios (not for 10% drop or 20% drop and $3000, nor for 35% drop and $2000).

If your time horizon is 15 years and you are risk averse, adding bonds is a reasonable idea.

Conclusions for a 20-year time horizon:

The 100% portfolio beat the 60%/40% portfolio in all scenarios but the last (40% drop and $3000 withdrawals).

If your time horizon is 20 years, adding bonds is a bad idea.

In the last 92 years (1928-2020), the market has been down 40% or more only 6 times—once every 15 years on average. (Carlson, Ben. “9 Historical Facts About the US Stock Market.” *AWealthof CommonSense*.*com*. 24 Jan. 2021. 29 Jan. 2021. Web.) If your retirement is 20 years off, is protecting against such a rare event really worth cutting in half (from 10% stock return to 5% bond return) the return on 40% of your portfolio?

Overall conclusion: the longer your time horizon, the less you need bonds.

For the money you will need within 10 years, include bonds in your portfolio. For the money you will not need within 10 years, hold 100% stocks.

For short-term investors, “Volatility is a primary risk since the near-term withdrawal of capital will lock in short-term results. So volatility is a primary concern, because as it increases, so too does the potential for forced sales at disadvantageous prices.” (Mishuris, Gary. “When Does Volatility Equal Risk?” *Blogs*.*CFAInstitute*.*org*. 5 Oct. 2017. 6 June 2021. Web.)

“Warren Buffett famously said that as a long-term investor he would “much rather earn a lumpy [i.e., volatile] 15% over time than a smooth [nonvolatile] 12%.” Following his logic, many modern value investors aren’t concerned with volatility.” (Ibid.)