PIMCO

Your Global Investment Authority

# MAPPING A PATH FORWARD

Bond strategies for an evolving market

## Helping your clients navigate the evolving bond market

Bond markets are evolving. After three decades of steadily declining interest rates, returns from duration, or interest rate risk, could begin to recede. This shift means that bond investors will need to think differently about how to pursue and reach their long-term financial goals.

There's no "one-size-fits-all" solution, of course. On the following pages, we offer a framework for how to think about your clients' bond allocations in the context of both their individual objectives and a changing, more diverse marketplace.

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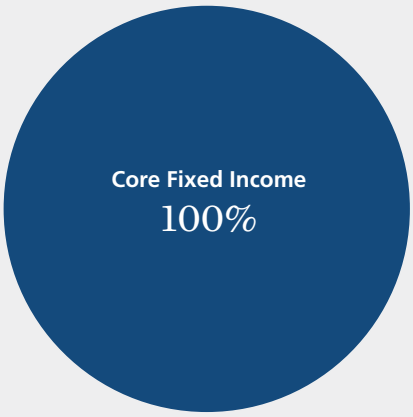
# MAPPING A PATH FORWARD:
## BOND STRATEGIES FOR AN EVOLVING MARKET

As fixed income markets shift and expand, investors should likewise broaden their thinking about how to target their bond objectives. Here are several paths that can serve as frameworks for conversations with clients about positioning their portfolios for today's changing landscape.

## TRADITIONAL CORE BOND

A core bond fund typically contains many of the qualities investors are seeking from fixed income, such as broad diversification, rigorous risk management and a flexible approach.

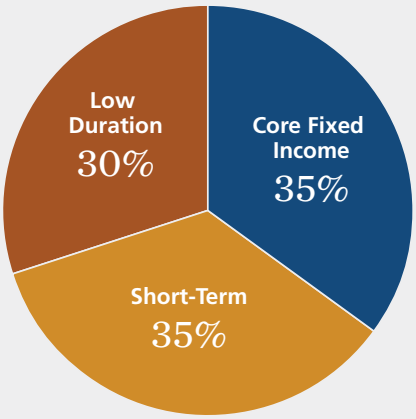



- **Goal:** Diversify equity risk; total return
- **Strategy:** Allocate to traditional core bond fund
- **How it works:** Actively managed to seek consistent, above-average returns through all market and interest rate environments. By tracking a bond benchmark such as Barclays Aggregate Index, it can serve as an important diversifier for stock holdings.
- **Considerations:** Traditional approach may limit access to full spectrum of bond opportunities.

| | Traditional Core Bond Sample Portfolio | Barclays U.S. Aggregate Index |
|---|---|---|
| **Yield** | 3.2% | 2.3% |
| **Estimated volatility** | 4.1% | 4.0% |
| **Equity correlation** | 0.04 | -0.21 |
| **Duration** | 5.0 years | 5.3 years |

## LOWER DURATION

Investors particularly concerned about rising rates may wish to complement their core bond holdings with allocations to low duration and ultra-short-term strategies. Together, they can reduce interest rate sensitivity, while also providing greater potential for positive real returns than shorter term investments alone.



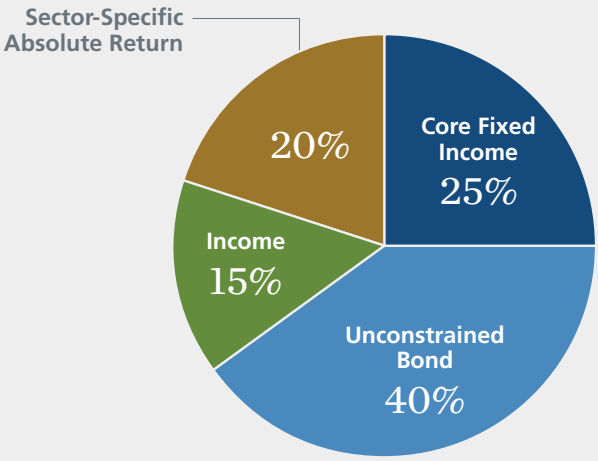

- **Goal:** Protect against rising rates and volatility
- **Strategy:** Shorten portfolio duration
- **How it works:** Shorter-duration fixed income strategies reduce interest rate exposure, providing some cushion against rising rates; a substantial core bond holding maintains reasonable exposure to total return potential.
- **Considerations:** May lower yield and reduce historical diversification benefits of fixed income vs. equities.

| | Lower-Duration Sample Portfolio | Barclays U.S. Aggregate Index |
|---|---|---|
| **Yield** | 2.0% | 2.3% |
| **Estimated volatility** | 2.5% | 4.0% |
| **Equity correlation** | 0.01 | -0.21 |
| **Duration** | 2.7 years | 5.3 years |

As of 31 March 2014.
Yield shown is yield to maturity.

## OPPORTUNISTIC

Uncertain markets often present compelling opportunities. Investors can take advantage by complementing their core allocation with unconstrained bond strategies that give skilled active investment managers wide discretion to invest across the global fixed income and currency landscape.

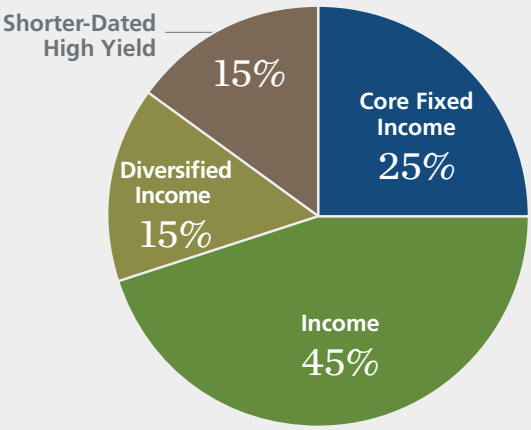



- **Goal:** Take advantage of timely opportunities
- **Strategy:** Focus on broad and sector-specific absolute return strategies, with some core bond exposure
- **How it works:** Because absolute return strategies seek positive returns rather than tracking a benchmark, they provide investment managers broad flexibility to identify value and opportunity – both for capital appreciation and income generation – which can help drive returns. Bond market exposure is maintained through the core bond holding.
- **Considerations:** High manager skill is essential and market exposures may deviate significantly from strategic asset allocation targets.

| | Opportunistic Sample Portfolio | Barclays U.S. Aggregate Index |
|---|---|---|
| **Yield** | 3.0% | 2.3% |
| **Estimated volatility** | 4.1% | 4.0% |
| **Equity correlation** | 0.19 | -0.21 |
| **Duration** | 3.1 years | 5.3 years |

## INCOME-FOCUSED

Low bond yields have challenged investors seeking sustainable income. An active approach to diversifying income sources across the global bond universe can seek attractive, consistent yield while managing risk.




- **Goal:** Focus on income to generate returns
- **Strategy:** Complement core bond fund with allocations to higher-yielding strategies and sectors
- **How it works:** Exposure to strategies designed to maximize income, as well as assets such as shorter-dated high yield bonds, can help build an attractive income stream. Diversification can help moderate the risks of these investments, while core bonds continue to provide a relatively steady anchor.
- **Considerations:** Relies on manager skill and exposure to more volatile sectors may result in greater portfolio risk than a traditional core bond portfolio.

| | Income-Focused Sample Portfolio | Barclays U.S. Aggregate Index |
|---|---|---|
| **Yield** | 4.4% | 2.3% |
| **Estimated volatility** | 5.9% | 4.0% |
| **Equity correlation** | 0.47 | -0.21 |
| **Duration** | 4.1 years | 5.3 years |

As of 31 March 2014.
Yield shown is yield to maturity.

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