Three ideas for fixed income investors today

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COLUMBIA THREADNEEDLE INVESTMENTS

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I think investors are struggling in fixed income for the right answer.

Three best ideas for investing in fixed income: Number one, be diversified. Don't put all of your eggs in a single part of the fixed-income basket. Own a very diversified portfolio. Number two, if there is a favored sector within that diversified portfolio, it would be high-quality corporate bonds, investment-grade corporate bonds. Companies that have some fundamentals in earnings, they may not be paying the highest dividend or the highest coupon but you can sleep at night. So the third area or third opportunity would be within emerging markets. And I wouldn't paint that with a broad brush but there are some select opportunities in certain countries where we see improving fundamentals. They're starting to get the benefit of higher commodity prices that may have been struggling a year or two ago but we see them on the upswing.

What keeps me up at night? There are a lot of things that make me nervous. I worry that investors are stretching for yield at the wrong time. There's a temptation to want and get a little bit more. So instead of having a 3%-yielding portfolio, you want a three-and-a-half-percent-yielding portfolio. But when you look at what it takes to try to do that, to try to increase that yield, you may have to stretch into areas of the corporate bond market or certain parts of the world in which you're just not getting adequately compensated for the risks of moving into those places for various reasons. And I would say this is one of those times in which you might want to generate income but accept a little less income in the name of safety and capital preservation.

I've been in the business for 30 years and during that period, it's pretty much been a one-way flow and one-way direction in terms of rates just moving lower and lower and lower. And the thing that I think about and I don't think is appreciated enough is many of the investors and professional investors haven't been in an environment of rising interest rates.

I'm not trying to incite a riot or cause people to pull all their money out of fixed income but just understanding and appreciating those risks out there. So we're trying to manage portfolios prudently that we can achieve the objectives of income, of generating stable sources of return and providing diversification, but in the back of our mind, we also want to manage it prudently where we can safeguard against that tail risk to the extent possible.

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