Short, Intermediate, or Long-Term Fixed Income

Which Should You Use?

Investors often ask, "When I build a portfolio comprised of stocks and bonds, should I use short-term, intermediate-term, or long-term bonds?" The answer is: "It depends."

The volatilities, annualized returns, and best years/worst years for short, intermediate, and long-term Treasuries from January 1, 1990, through December 31, 2020, are shown below:

	Return	Std. Dev.	Best Year	Worst Year
Short-Term Treasuries	3.20%	0.99	+9.9%	-0.1%
Intermediate-Term Treasures	5.57%	4.17	+16.8%	-5.6%
Long-Term Treasuries	7.98%	10.07	+31.7%	-14.9%

On a stand-alone basis, longer duration bonds have higher returns than lower duration bonds, but more volatility. However, this linear pattern can change when bonds are combined in a portfolio with stocks.

The graphic below shows the volatilities and annualized returns of a portfolio that includes 60% stocks and 40% short, intermediate, and long-term bonds over the same period.

	Return	Std. Dev.	Best Year	Worst Year
60/40 (Short-Term)	7.80%	8.70	+32.9%	-25.6%
60/40 (Intermediate-Term)	8.82%	8.59	+34.5%	-24.2%
60/40 (Long-Term)	9.95%	9.06	+37.3%	-22.1%

The volatility of the portfolio using intermediate-term bonds is less than the volatility of the portfolio using short-term bonds. Also, the worst years for the portfolios using intermediate and long-term bonds involve smaller losses than for the portfolio holding short-term bonds.

This happens because intermediate and long-term bonds have lower correlations to stocks than short-term bonds during this period.

Investors who seek to make their portfolio less risky by holding short-term bonds alongside their stocks may actually be increasing their overall risk.

It Depends On Your Goals

That is why it is important to identify your goals and consider the effect that each holding has as part of the total portfolio, rather than viewing them in isolation.