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WEALTH BLUEPRINT

LADDERING THROUGH UNCERTAINTY

KEY POINTS

- Bond ladders provide regular reinvestment opportunities, helping investors manage interest rate risk while continuing to earn income from bond yields.
- Laddered bond portfolios support financial resilience by spreading investments across different maturities and helping generate reliable income streams that can match an investor's cash flow needs.
- Laddered bond portfolios support long-term wealth management generation through its predictable cash flows, improved flexibility, and practical ways to manage interest rate risk.

The on-going oil supply shock, compounded by fiscal and geopolitical risks, has led to higher inflation for oil-importing economies such as the Philippines. This, in turn, has raised expectations that the BSP may need to maintain a tighter policy stance, creating a more challenging environment for bond investors. Given the inverse relationship of interest rates and bond prices, a "higher for longer" rate environment can lead to significant price declines, especially for longer-term bonds. To help manage these risks, investors may consider adopting a **bond laddering strategy** within their fixed income portfolios. This strategy can help investors attain greater flexibility and help balance reinvestment risk, interest rate risk, and liquidity needs.

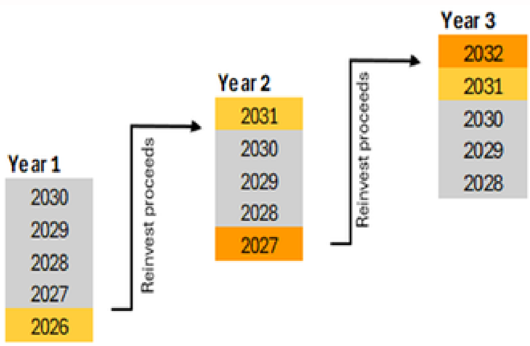
Bond laddering is a strategy that involves holding fixed income securities with staggered maturity dates. This is designed to help manage interest rate risk by spreading investable funds across different bonds and maturity intervals. Instead of concentrating investments in one maturity period, its "spaced" maturities help smooth bond yield entry points as investors can reinvest capital in new bonds at prevailing interest rates. This makes bond laddering a disciplined process of reinvesting capital. This strategy caters to investors seeking to navigate a rising interest rate environment by reducing the impact of rate movements because not all investments mature or need to be reinvested at the same time. It also provides a more structured way to manage bond investments, while allowing investors to continue earning income from bond yields.

Building a Rolling Bond Ladder

Bond ladders are built by purchasing securities across different "rungs" or maturity buckets. This involves dividing the funds to be invested across the desired number of rungs, then selecting bonds with maturity dates that align with the investor's expected cash flow needs.

For example, investors with sizable annual drawdowns may structure their bond ladder with maturities spaced one year apart, allowing cash to become available on a regular schedule.

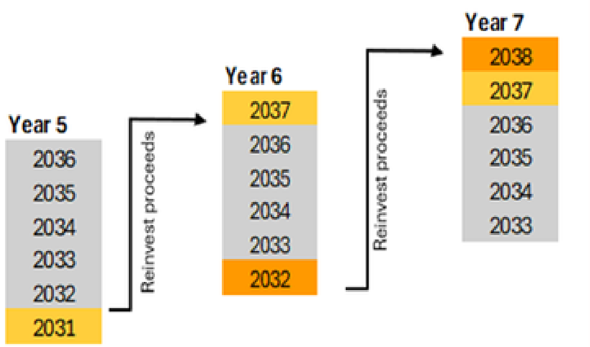
Figure 1. 1-5Y Laddered Bond Portfolio



As each bond matures, the proceeds may be "rolled over" or reinvested into a new bond, usually one with a longer maturity at the top of the ladder. Depending on the investor's risk profile and liquidity needs, the ladder can also focus on a specific part of the yield curve, such as medium-term bonds.

An example of this is a 5-10 year laddered bond portfolio. In this case, once a bond reaches its fifth year, the investor may sell and reinvest the proceeds into a new 10-year bond. Reinvesting or rolling up the proceeds to the 10-year bond, the longest rung for this ladder improves overall bond return as bonds with longer maturities offer higher yield over bonds with shorter maturities.

Figure 2. 5-10Y Laddered Bond Portfolio



In a rising interest rate environment, proceeds from bonds that mature earlier can be reinvested into new bonds with higher yields. This can help improve the overall income of the portfolio over time. Conversely, in a falling interest rate environment, the impact of lower reinvestment rates is reduced because only the proceeds from maturing bonds need to be reinvested, while the rest of the portfolio continues to earn its existing yields.

Another important consideration is credit quality. Bond ladders are usually built with risk-free securities, which are generally used to prioritize capital preservation and predictable income, especially when held to maturity. To improve potential returns, investors may also include high-quality corporate bonds that offer higher yields. By diversifying across credible issuers and prioritizing non-callable bonds, investors can help reduce default risk and maintain predictable cash flows.

Benefits of Bond Ladders

Sustainable and Reliable Income Stream
Laddered portfolios can generate regular cash flows that match a specified timeline of financial obligations. By combining bonds with different maturities, investors can build a steady and sustainable income stream that can help address future expenses such as tuition fees, lease arrangements or other planned obligations. Access to regular maturity proceeds gives investors the option to use the capital as needed or roll it back into the ladder.

Flexibility
Positioning across multiple bonds with staggered maturities provides regular reinvestment opportunities. Investors can reinvest maturity proceeds in new bonds at prevailing market rates. Since longer-dated bonds typically offer higher yields than shorter-dated bonds, proceeds are often reinvested at the end of the ladder to seek higher income. However, investors also have the option to adjust the portfolio's liquidity based on their cash flow needs. Investors who need more funds in the near term can keep maturities shorter for easier access to cash, while those with fewer immediate needs can extend maturities to lock in potentially higher yields.

Portfolio Structure
A laddered bond portfolio spreads investments across different maturities, helping reduce the risk of locking in a single interest rate, which can happen with more concentrated strategies. It may also lower the need to sell bonds at a loss when rates rise, since the portfolio has bonds that mature at different points in time. This structure can make the portfolio more resilient in changing interest rate environments.

Bond ladders provide regular reinvestment opportunities and help improve flexibility and liquidity. This can create a steady and reliable income stream, which may be especially useful for investors planning for retirement or other long-term financial needs. With more predictable cash flows and a practical way to manage interest rate and reinvestment risks, laddered bond portfolios offer a disciplined approach to supporting capital preservation while generating income over time.

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