



## PRATO CAPITAL

# What's in a name?

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A name or title doesn't always tell the whole story. Whether it's about the Dutch or about bonds, terms can be misunderstood and misleading sometimes.

### What does everyone think of when they hear Holland or Dutch?

Is Holland a country? Is Dutch a language or a nationality?

Many think of Holland as a country in Europe that is famous for tulips, windmills, cheese, wooden clogs, and enthusiastic football (soccer) fans. But Holland is not a country at all, just 2 provinces, North Holland and South Holland, in the country of the Netherlands. There are actually 12 provinces in the Netherlands.

Why are citizens of the Netherlands called Dutch and not "Netherlanders"? Only English-speaking countries refer to the citizens of the Netherlands as Dutch. This started centuries ago when the English referred to anyone who spoke a Germanic language as Deutsch or Dutch. Eventually the citizens from Germany were called Germans but the citizens from the Netherlands were still referred to as Dutch. Even the German and Swiss immigrants that settled in Pennsylvania in the 18<sup>th</sup> century were referred to as 'Dutch' due to the language they spoke and not the country they were emigrating from.

With many of these terms having different meanings, the easy one is the official language of the Netherlands. It is Dutch.

Words can have different meanings and sometimes they can be misleading.

### How misleading can the term 'Bonds' be?

Many investors assume bonds are risk free and a stable part of a balanced and diversified portfolio. **This is a misleading assumption and is not necessarily true.** There are some degrees of risk associated with all types of investments, including bonds. There are generally two types of risk to bonds – interest rate risk and credit risk. With interest rate risk, bond prices are directly related to interest rates. As interest rates rise, generally bonds decrease in value and the Federal Reserve has indicated that rates will probably rise sometime during 2022 or 2023. Credit risk is associated with the credit ratings for companies and the possibility of default on the bond.

### Bonds in a portfolio

Our [July 2020 newsletter](#) discusses how bonds and fixed income can complement the equity side of a balanced and diversified portfolio. It is as applicable now as it was over one year ago.

Many investors spend most time and effort selecting equities for their portfolio with the bonds and fixed income as just an afterthought. For any investor, it is important to consider that bonds can be up to 50% or 60% of their entire portfolio and it can have a significant impact on returns. Having a complete investment strategy that carefully considers both stocks **and** bonds is critical and can be very beneficial to the overall returns generated by the portfolio. Now as we approach the end of 2021, the risk associated with possible rising interest rates and its effect on bonds overall, make the proper allocation even more important.

Long term or short term, US Treasury or corporate, high-yield or investment grade, munis or TIPS, domestic or international - with so many different types of bonds and bond funds available in the market, how can the investor choose the right one for their portfolio? The truth is it depends. What to choose is different for every investor since everyone has different goals for the bonds in their portfolio. Some view bonds as a balance to any stock market volatility, some view bonds as a source of income, and others look to bonds as a tool for additional capital gains. There are ways to decrease risk within the bond portion of any portfolio regardless of investor objectives. Diversification in bonds is as important as it is with stocks. This ultimately reduces overall risk and provides more reliable portfolio returns over the long-term. This should be the goal of all investment plans and it is best worked out with a financial advisor like Prato Capital.

### **Conclusion**

Like the words 'Dutch' and 'Holland,' bonds may have different meanings and can be misleading for some investors. As we approach a period of changing interest rates, it is more important than ever that investors understand the impact that different bonds can have on their overall portfolio.

At Prato Capital, we feel all investors are best served with an investment plan that is part of a complete financial plan, like our Financial Life Plan. This helps determine the growth and risk needed to grow a portfolio for the future. We advise our clients not just on equities and stocks, but also on the proper bond allocation for their individual needs. Including the rising interest rate environment we may see over the next couple of years. This is just one of the benefits when working with us at Prato Capital.

*"An investment in knowledge always pays the best interest." – Benjamin Franklin.*