

The bonds in *your portfolio*.

Bonds do a different job than stocks. Stocks are the growth engine. Bonds are the stability engine — the part of the portfolio that lets the rest of it do its work. This piece is the plain-language explanation of how we choose them, and why the answer isn't “just buy an index fund and forget it.”

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Where the bond design matters most: protecting the years you spend the money.

Forecasting interest rates is unreliable. Tracking an arbitrary bond index leaves money on the table. *There is a third option, and your portfolio uses it.*

— MPM WEALTH ADVISORS • INVESTMENT COMMITTEE

Three jobs. Stocks *can't* do any of them.

Before we talk about *which* bonds to own, we should be clear about *why* we own them. Bonds aren't a growth play. They're three other things, all of which matter more than people realize.



JOB 01

Dampen the swings

A 100% stock portfolio is too volatile for most people to hold through a bad year — **and clients who sell in the bad years lock in the loss**. Bonds reduce the size of the drawdowns, which makes the plan actually possible to stick to.



JOB 02

Pay reliable income

Bonds pay interest on a schedule. In retirement, that schedule becomes the source of regular spending money — **without having to sell anything**. The income comes whether the market is up or down that month.



JOB 03

Match specific futures

If you'll need \$80,000 in five years for a child's college, you don't want that money in stocks. A bond maturing in five years **locks in the dollar amount** — it's the financial equivalent of putting a specific dollar in a specific envelope for a specific purpose.

What bonds are *not* for: driving long-term growth. Over decades, stocks have outpaced bonds significantly — that's the price stocks pay you for the volatility you accept. If your time horizon is 30 years and you can stomach the swings, a heavier stock allocation will usually produce more wealth. Bonds aren't competing with stocks; they're doing a different job.

So why do we put any thought into them? Because the way the bond piece is built has a real impact on the two things bonds are supposed to do well: *income* and *protection*. Get the design right and your bonds quietly pay you more, with less risk of a bad surprise. Get it wrong and you're holding a low-yielding pile that doesn't help when you need it. The rest of this document is about getting the design right.

Three patterns. *Fifty years* of data.

Just as research has identified three patterns that drive higher returns in stocks (size, value, profitability), **three corresponding patterns drive higher returns in bonds**. They aren't speculative; they're documented across decades and across the developed world.



PATTERN 01

Term: *longer* bonds

Bonds with longer maturities have, on average, paid more than short ones.

The intuition: locking up your money for 10 years is riskier than for 1 year. Investors demand extra return for the wait — and historically, they've gotten it. **Average extra return: about 0.6 percentage points per year**, US intermediate vs. short-term government bonds, 1976–2023.

+57 bps/yr · 1976–2023



PATTERN 02

Credit: *weaker* borrowers

Bonds from less-creditworthy borrowers have paid more than the safest government bonds.

The intuition: a corporate bond carries a small chance the company can't pay you back. Investors demand extra yield for that risk — and on average, the extra yield has more than compensated. **Average extra return: about 0.9 percentage points per year**, US investment-grade corporate vs. government bonds, 1976–2023.

+93 bps/yr · 1976–2023



PATTERN 03

Currency: *where* the bond is issued

Bonds issued in different currencies often have very different yields — for the same risk.

The intuition: at any given moment, German government bonds may offer a higher hedged yield than US Treasuries, or vice versa — reflecting where capital is flowing. **Owning bonds from multiple countries**, and tilting toward the highest yielders after hedging the currency back to dollars, has added meaningful return.

+41 bps/yr · 1985–2023

PLAIN-LANGUAGE FOOTNOTE

You may hear these called *term premium*, *credit premium*, and *currency premium*. **They mean the same thing as what's above.** A “premium” in this context just means “the extra return on average from accepting a particular kind of risk.” The patterns are real, but they're not guarantees: there are years when long bonds underperform short ones, and years when corporate bonds lose money even as Treasuries gain.

Why these patterns matter: if all three are real and persistent, then a bond portfolio that *moderately* tilts toward longer, lower-credit, and higher-yielding-currency bonds should — on average, over time — out-earn a bond portfolio that doesn't. The question is whether we can capture them without taking on the kinds of risk that defeat the purpose of holding bonds in the first place.

Yes — *carefully*. The next section is about how.

Forecasters, indexers, and *a third option*.

The same three-approach story we told for stocks plays out in bonds — with a twist. The first two approaches have well-documented flaws specific to fixed income.

APPROACH A	APPROACH B	APPROACH C • WHAT WE USE
Active forecasters <i>Predict where interest rates are going, then position accordingly.</i> • Buy long bonds if they think rates are about to fall • Buy short bonds if they think rates are about to rise • Bet on which company defaults won't happen • Track record: interest-rate forecasting is one of the most-studied and least-successful disciplines in finance	Index trackers <i>Hold whatever a published bond index says to hold, in the weights the index says to hold them.</i> • Lower cost than active forecasting • No reliance on predictions • Ignores info already in the yield curve about expected returns • Holds the index's weightings even when prices say otherwise	Systematic <i>Use the information already in current bond prices to tilt deliberately — without predicting anything.</i> • Owns broadly diversified bonds across maturities, credit, and currencies • Tilts toward higher-yielding maturities when the term spread is wide • Tilts toward credit when the credit spread is wide • Tilts toward higher-yielding currencies (hedged to USD)
Track record Unreliable	Goal Match the index	Track record +28 to +140 bps/yr

The key insight behind the systematic approach: the bond market's current yield curve already contains reliable information about which bonds offer the highest expected returns going forward. When long bonds are paying meaningfully more than short bonds — a wide “term spread” — that's been a reliable signal of a higher term premium ahead. When corporate bonds are paying meaningfully more than government bonds of the same maturity — a wide “credit spread” — that's been a reliable signal of a higher credit premium ahead.

The systematic approach doesn't try to predict where rates are going. *It just reads what the market is already telling us about expected returns, and tilts the portfolio accordingly.* No forecast required.

WHEN THE TERM SPREAD IS WIDE VS. NARROW — THE SYSTEMATIC RESPONSE

WIDE TERM SPREAD



NARROW TERM SPREAD



Long bonds pay much more than short.

We *increase* exposure to longer bonds — up to 75% intermediate-term — capturing the bigger expected term premium.

Long bonds barely pay more than

short. We *reduce* exposure to longer bonds — the extra interest-rate risk isn't being compensated.

Variable maturity, credit, and currency — *with the value-add to prove it.*

Dimensional has published simulations of each systematic bond tilt over the longest periods data is available for. **Each tilt, on its own, has added meaningful return at modest additional risk.** Combined into a global core bond portfolio, the value-add is larger still.

ANNUALIZED VALUE-ADD VS. BENCHMARK · SYSTEMATIC FIXED INCOME SIMULATIONS

Variable maturity

Length of bonds, US, 1976–2023



+28 bps

72% of years

Variable credit

Quality of borrowers, US, 1973–2023



+45 bps

78% of years

Variable currency

Across developed countries, 1985–2023



+41 bps

62% of years

US core (combined)

Maturity + credit, 1999–2023



+41 bps

vs. Bloomberg US Agg

Global core (combined)

All three, hedged to USD, 1999–2023



+140 bps

vs. Bloomberg Global Agg

The compounding matters. An extra 0.41% per year on a \$1M bond allocation across 20 years adds roughly \$87,000, all else equal. The numbers look small on a single year, large on a lifetime. Source: Dimensional, “The Case for Systematic Investing in Fixed Income,” 2024. Past performance does not guarantee future results.

Where the bond design *matters most*.

In your working years, bonds are 20–40% of the portfolio. The systematic tilts add a modest but real number to total return, and reduce the volatility of the overall portfolio — making it easier to stay invested when stocks have a bad year.

In retirement, bonds become the primary source of stability. They're what you live on while stocks recover from the inevitable bad stretches. The way they're designed determines whether your income holds up against two specific threats: *unexpected inflation*, which erodes the purchasing power of fixed payments, and *falling rates*, which reduce the income you can replace bonds with as they mature. Most plain bond portfolios are vulnerable to both. **An income-focused design — using inflation-protected bonds and matching bond maturities to your actual cash-flow needs — addresses both.**

A

We don't forecast interest rates.

Decades of research show it's unreliable, and the cost of being wrong is large. We use what current prices are already telling us instead.

B

We tilt deliberately, not aggressively.

Our bond holdings stay broadly diversified across maturities, credit qualities, and countries. The tilts move within bounded ranges — never all-or-nothing.

C

We hedge currency back to dollars.

Foreign-currency bond returns get swamped by exchange-rate noise. Hedging the currency back to USD lets us own bonds globally *without* taking on currency risk.

D

We use inflation protection where it matters.

For the retirement income piece of your portfolio, we use inflation-protected Treasuries (TIPS) and other instruments that adjust with the cost of living — not bonds whose payments stay nominal while groceries rise.

E

We keep costs and turnover low.

The same insight from stocks applies double for bonds: *every basis point you don't pay in fees or trading costs is one you keep*. We use funds in the lowest-cost tier of every category.

PLAN. INVEST. THRIVE.

The bonds in your portfolio aren't *boring* —

they're doing one of the most important jobs in the plan. The way they're designed determines whether your spending money is there when you need it, whether your portfolio survives a bad market, and whether your purchasing power keeps up with inflation. Quiet, careful work. *The kind that compounds.*