Should you hedge your bond portfolio?

David Vomund
Market Pulse

The yield on the 10-year Treasury has jumped from 1.9 percent to over 2.2 percent in the last month. Global rates rose, too, and the higher rates adversely affected many bond funds.

The 20+ U.S. Treasury ETF (TLT) lost 10 percent. Vanguard's Total International Bond Index Fund (VTIBX) lost 2.5 percent, which is a big move considering it only yields 1.5 percent. Is it time to hedge your bond portfolio?

Many people think so. Money is pouring into Direxion Daily 20-Year Treasury Bear 3X (TMV), a fund that attempts to deliver triple the daily inverse returns in Treasuries.

When Treasuries lost 10 percent, TMV rose 30 percent on huge volume. But buyer beware.

Leveraged and inverse funds serve a purpose for day traders, but are not good long-term investments.

Just look at 2008. Suppose someone had the foresight to predict the fall in real estate values and bought ProShares UltraShort Real Estate (SRS).

If he bought SRS on October 1, 2008, right before the financial collapse, and held it through the rest of that year, he would have lost 30 percent.

Another example, Chinese stocks lost half their value from mid-March 2008 through October 2008, but ProShares Ultra-Short China (FXP) lost nearly 20 percent of its value.

Some bond ETFs place hedge more efficiently by matching durations to their bond holdings.

Two good examples are ProShares Investment Grade Interest Rate Hedged (IGHG) and ProShares High Yield Interest Rate Hedged (HYHG), which yields 6.7 percent.

I'm not hedging my fixed-income portfolio. I've avoided Treasuries and short-term investment grade corporates because their low yields make them vulnerable to rising rates.

Rates would have to go much higher, however, to make high yielding bonds and non-REIT preferreds unattractive. I don't expect that.

A few months ago most everyone expected the dollar to continue its move higher. It didn't. Now it is widely assumed that interest rates will head higher.

When everyone is on one side of a trade count on a move in the opposite direction. I don't expect much higher rates and hold no hedges in my portfolio.

For those who want to protect their portfolio from rising rates, some ETFs can help.

David Vomund is an Incline Village-based fee-only money manager. Information is found at www.VomundInvestments.com or by calling 775-832-8555. Clients hold the positions mentioned in this article. Past performance does not guarantee future results. Consult your financial advisor before purchasing any security.