



CAPSTONE

Building Wealth, Controlling Risk

## WHY ACTIVE BOND MANAGEMENT?

### Active Bond Management

Active Management: A portfolio strategy of managing assets by continually repositioning portfolios to take advantage of the most favorable opportunities.

- Takes advantage of bond market inefficiencies
- Portfolio is adjusted when opportunities arise and when market conditions change
- Duration management = risk control
- Tax sensitive management can be applied
- Active decisions are made to properly weight the portfolios by sector and credit diversification
- Application of yield curve strategies
- Application of sector rotation
- Specific security selection adds value
- If interest rate declines are anticipated, managers can increase portfolio duration (and vice versa)

### Passive Strategies / Laddered Bond Portfolios

Laddering: A fixed income portfolio strategy in which assets are distributed evenly over a range of maturities.

- Tracks a pre-determined index
- Equal amounts of bonds mature on a regular basis
- Avoids need for interest rate analysis
- Avoids need to monitor credit quality
- Commits to interest rates the day the ladder is created
- Does not adjust during periods of change in the market (yield curve)
- Redeploys cash further out on the yield curve immediately after bonds mature
- Lacks sector diversification
- No tax management applications

### Active Management Techniques

- Capstone optimizes opportunities and avoids pitfalls as they are identified.
  - Changes in the level of interest rates
  - Changes in the shape of the yield curve
  - Changes in yield spreads across and between sectors
  - Changes in relative value of individual investments

### Conclusion

- Although bond laddering is a common passive investment strategy, it has inherent limitations. The bond market offers active managers significant structural and tactical opportunities to potentially produce higher returns than laddered portfolios, an increasingly important consideration because total returns on financial assets are expected to be modest in the coming years.
- Core active bond managers can potentially create greater alpha and thus higher pre- and after-tax total returns than passive, laddered portfolios because active managers can exploit a number of inefficiencies and small, diverse sources of value in the bond market. In addition, active managers can utilize several techniques, such as duration management, yield curve strategies, sector rotation, security selection and tax management, which have the potential to provide excess returns and risk management not available to passively managed, laddered portfolios.



### Fixed Income Approach

At Capstone, we recognize the fundamental differences between the primary objectives and risk tolerances of investors. We have designed fixed income products and services to provide optimal sets of portfolio characteristics to achieve the needs and requirements for a diverse group of clients. While some of our fixed income products seek superior total rates of return, other portfolios are designed to maximize current income, maintain specific credit controls or help tax needs. Our approach to all client accounts is to optimize available investment opportunities into portfolios which, given the stated objectives, provide the greatest possible long-term growth while assuming the lowest degree of principal risk.

At Capstone, we have developed products and services to meet the needs of “total return” investors and their asset allocation needs as well as “income-oriented” investors via the following strategies:

- “Fixed Income” : total return
- “Intermediate Fixed Income” : less interest rate sensitive, total return
- “Current Income Portfolio” - cash flow and income
- “Tax Exempt Fixed Income” (Municipal) - total return, tax benefits

### Capstone Adds Value

We focus our efforts first on identifying the present relative value across the full spectrum of Investment Grade U.S. debt market securities. We then merge these findings into an optimal mix of characteristics. Whether managing separate accounts for maximum total return or income, we seek to add investment value by:

- controlling interest rate risk
- identifying advantageous yield curve sectors
- rotating credit sectors
- rebalancing allocations
- employing special security structures

### Fixed Income Investment Process

Capstone employs a disciplined 4 step process in the management of Fixed Income accounts. This process has provided clients with above market returns with lower than market risk for over 20 years.

