Warren Buffett: Bond Investors Face a Bleak Future — Here’s How to Cope

Description

In Warren Buffett’s latest letter to **Berkshire Hathaway** shareholders, the man took a big jab at bonds. He went as far as to say that bond investors faced a “bleak future” with bond yields still considerably below the 2% mark. There’s no denying Buffett’s statements. Real yields or yields adjusted for inflation (expected at 2%) are still negative, meaning investors who hold bonds will lose ground through the insidious effects of inflation over time.

Warren Buffett: Bond investors face a “bleak future”

Gone are the days of free lunches: the double-digit bond yields from the early 1980s.

Retirees, conservative investors, and all the sort will need to adapt to the times or be left with sub-par returns that may not be enough to finance a comfortable retirement. For retirees or soon-to-be retirees, that means either taking on more risk or staying in the workforce longer.

As an older investor, you can’t really afford to take on excessive amounts of risk. As you’ve probably heard numerous times, stocks are the only game in town in today’s low-rate environment. That doesn’t mean you need to participate in some of the riskier areas of the market, though.

There are magnificent bond proxies on the **TSX Index**, and many of them are at rock-bottom valuations, with yields on the higher end of their historical range. It’s these such defensive dividend stocks that I believe are less risky versus the likes of fixed-income debt securities when you weigh the opportunity costs.

Should you settle for lower yields or make the jump to bond proxies?

There are no guarantees in the world of equities. Low betas and bond proxies can still crumble like a paper bag when the stock market suffers a cash-crunching market crash or an “everything sell-off,” like the one suffered in February and March 2020, when everything collectively fell off a cliff, warranted or not. Heck, even the most conservative of bond funds dipped, albeit temporarily.

Despite the lack of “guarantees” that accompany GICs (guaranteed investment certificates), bond proxies have a profoundly better risk/reward trade-off.

The 1.4% 10-year U.S. Treasury note pales in comparison to the 4% dividend yield of the likes of a **Fortis** (TSX:FTS)(NYSE:FTS). And unlike bond coupons, Fortis’s dividend payout is slated to grow at a 4-5% rate every single year. If that’s not a good deal, I don’t know what is. While Fortis’s payout isn’t guaranteed, I believe it’s the closest thing to a guarantee that you’ll get in the world of the “risky” equity market.

Moreover, Fortis stock has been in a slump of late amid the rush to risk-on securities that promise greater returns over the nearer term. With the recent growth-to-value rotation, I think “Steady Eddie” utility stocks could be bid up, especially since Warren Buffett recently backed up the truck on hard-hit dividend payers in the fourth quarter.

At these valuations, Fortis has a wide margin of safety.

Although shares are facing negative momentum, I’d urge bond investors to consider dipping a toe into the equity markets, so they’re able to get the yield they need to retire comfortably. Bond yields are still one of the worst deals in town these days. If you’re looking to create an income stream for yourself and are willing to hold onto your share come the next market crash, which could hit FTS stock by as much as 20-30%, Fortis and other bond proxies may be worth betting on, as you look to adapt with the times.

Foolish takeaway

Warren Buffett is a reluctant bond investor. But he’s still a bigger fan of equities, especially dividend stocks with bountiful, well-covered payouts. I think it’d be wise for bond investors to follow in the man’s footsteps with dirt-cheap dividend stocks and bond proxies over fixed-maturity securities here.

There’s no free lunch in the world of fixed income anymore. That’s why it’s vital to weigh your options and evaluate the real opportunity costs at hand.

Stay Foolish.

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