

---

## Rising Rates: Short-Term Pain for Long-Term Gain?

Thomas Meinke  
Investment Strategist and Vice President

Wes Crill, PhD  
Head of Investment Strategists and Vice President

Oct 10, 2022

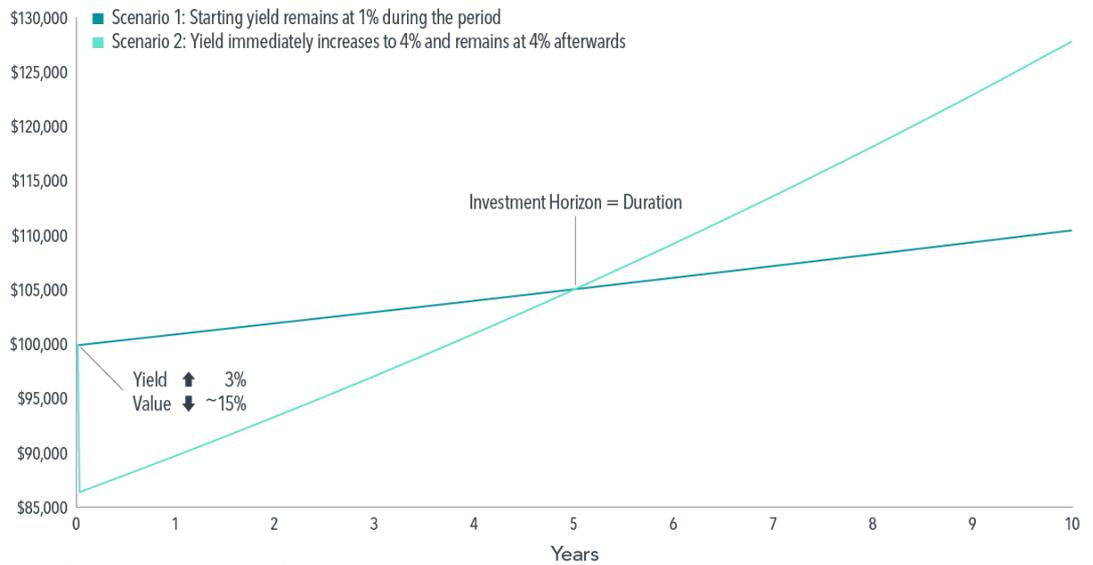
Investors have likely noticed the improved opportunity set in fixed income due to higher yields. And yet some investors may be hesitant to take advantage of higher yields because of concerns about future increases in yields. Some may even be considering reducing their bond exposure after this year's negative returns for fixed income.<sup>1</sup> The good news? If yields do keep rising, investors seeking higher expected returns may still be better off maintaining the duration of their fixed income allocation.

Rising yields impact fixed income portfolios in several ways. On the one hand, longer-duration portfolios may experience larger immediate losses from increased yields relative to shorter-duration portfolios. On the other hand, higher yields may lead to higher expected returns. Investors can think of this tradeoff as a pit stop in a Formula 1 race. The pit stop immediately causes the driver to fall back. However, fresh tires may help the driver win the race if there are enough laps left to catch the leader.

**Exhibit 1** illustrates this using two scenarios for a \$100,000 fixed income allocation with a five-year duration. Scenario 1 experiences a constant yield of 1% during the period. Scenario 2 is faced with a sudden spike in yield from 1% to 4% on Day 1 and sees its value immediately drop to a little over \$86,000. However, the higher-yield environment accelerates Scenario 2's recovery: With a 4% yield rather than the previous rate of 1%, Scenario 2's portfolio value overtakes Scenario 1's within five years—the time horizon determined by the duration of Scenario 2.

**Exhibit 1****Recovery Race**

Growth of a \$100,000 fixed income allocation with a five-year duration



*For illustrative purposes only.*

*Data presented are based on mathematical principles, are not representative of indices, actual investments, or actual strategies managed by Dimensional, and do not reflect costs and fees associated with an actual investment. Growth of wealth assumes a constant duration and flat yield curve for simplicity.*

*For Scenario 2, the approximate 15% drop in value seen in year 0 is based on a hypothetical yield increase from 1% to 4%, resulting in an immediate decline in value. The drop in value can be approximated by multiplying the assumed five-year duration by the yield increase.*

*Fixed income securities are subject to increased loss of principal during periods of rising yields.*

*Source: Dimensional.*

When faced with uncertainty, investors should focus on the things they can control. Research tells us that trying to outguess the market by holding on to cash, or shortening duration, with the expectation of future yield increases may not help you achieve your long-term goals.<sup>2</sup> Markets quickly incorporate new information about higher interest rates and inflation.<sup>3</sup> Investors who maintain appropriate asset allocations, even after increases in bond yields, may have a more rewarding investment experience in the long run.

**Duration:** A measurement of the sensitivity of the price of a fixed income investment to changes in interest rates. Generally, high-duration bonds will have greater sensitivity to changing interest rates than lower-duration bonds.

- 
1. The Bloomberg Global Aggregate Bond Index (hedged to USD) returned –12.1% from January 1, 2022, through September 30, 2022.
  2. Mingzhe Yi, “All Eyes on the Fed? A Look at Federal Funds Rate, Bond Return, and Term Premium,” Insights (blog), Dimensional Fund Advisors, March 15, 2022.
  3. Wes Crill, “Light at the End of the Inflation Tunnel,” Insights (blog), Dimensional Fund Advisors, June 10, 2022; “Markets Appeared to Be Ahead of the Fed,” Insights (blog), Dimensional, June 16, 2022.
- 

The information in this material is intended for the recipient’s background information and use only. It is provided in good faith and without any warranty or representation as to accuracy or completeness. Information and opinions presented in this material have been obtained or derived from sources believed by Dimensional to be reliable, and Dimensional has reasonable grounds to believe that all factual information herein is true as at the date of this material. It does not constitute investment advice, a recommendation, or an offer of any services or products for sale and is not intended to provide a sufficient basis on which to make an investment decision. Before acting on any information in this document, you should consider whether it is appropriate for your particular circumstances and, if appropriate, seek professional advice. It is the responsibility of any persons wishing to make a purchase to inform themselves of and observe all applicable laws and regulations. Unauthorized reproduction or transmission of this material is strictly prohibited. Dimensional accepts no responsibility for loss arising from the use of the information contained herein.

This material is not directed at any person in any jurisdiction where the availability of this material is prohibited or would subject Dimensional or its products or services to any registration, licensing, or other such legal requirements within the jurisdiction.

“Dimensional” refers to the Dimensional separate but affiliated entities generally, rather than to one particular entity. These entities are Dimensional Fund Advisors LP, Dimensional Fund Advisors Ltd., Dimensional Ireland Limited, DFA Australia Limited, Dimensional Fund Advisors Canada ULC, Dimensional Fund Advisors Pte. Ltd., Dimensional Japan Ltd. and Dimensional Hong Kong Limited. Dimensional Hong Kong Limited is licensed by the Securities and Futures Commission to conduct Type 1 (dealing in securities) regulated activities only and does not provide asset management services.

**Fixed income securities are subject to increased loss of principal during periods of rising interest rates. Fixed income investments are subject to various other risks, including changes in credit quality, liquidity, prepayments, call risk, and other factors. There is no guarantee strategies will be successful.**

## Risks

**Investments involve risks. The investment return and principal value of an investment may fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original value. Past performance is not a guarantee of future results. There is no guarantee strategies will be successful.**

## UNITED STATES

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

Investment products: • Not FDIC Insured • Not Bank Guaranteed • May Lose Value

Dimensional Fund Advisors does not have any bank affiliates.

## CANADA

These materials have been prepared by Dimensional Fund Advisors Canada ULC. The other Dimensional entities referenced herein are not

registered resident investment fund managers or portfolio managers in Canada.

This material is not intended for Quebec residents.

Commissions, trailing commissions, management fees, and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Unless otherwise noted, any indicated total rates of return reflect the historical annual compounded total returns, including changes in share or unit value and reinvestment of all dividends or other distributions, and do not take into account sales, redemption, distribution, or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently, and past performance may not be repeated.

#### AUSTRALIA

This material is issued by DFA Australia Limited (AFS License No. 238093, ABN 46 065 937 671). This material is provided for information only. No account has been taken of the objectives, financial situation or needs of any particular person. Accordingly, to the extent this material constitutes general financial product advice, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to the investor's objectives, financial situation and needs. Investors should also consider the Product Disclosure Statement (PDS) and the target market determination (TMD) that has been made for each financial product either issued or distributed by DFA Australia Limited prior to acquiring or continuing to hold any investment. Go to [dimensional.com/funds](https://dimensional.com/funds) to access a copy of the PDS or the relevant TMD. Any opinions expressed in this material reflect our judgement at the date of publication and are subject to change.

#### NEW ZEALAND

This material is issued by DFA Australia Limited (incorporated in Australia, AFS License No. 238093, ABN 46 065 937 671). This material is provided for information only. This material does not give any recommendation or opinion to acquire any financial product or any financial advice product, and is not financial advice to you or any other person. No account has been taken of the objectives, financial situation or needs of any particular person. Accordingly, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to the investor's objectives, financial situation and needs. Investors should also consider the Product Disclosure Statement (PDS) and for the Dimensional Wholesale Trusts the target market determination (TMD) that has been made for each financial product or financial advice product either issued or distributed by DFA Australia Limited prior to acquiring or continuing to hold any investment. Go to [dimensional.com/funds](https://dimensional.com/funds) to access a copy of the PDS or the relevant TMD. Any opinions expressed in this material reflect our judgement at the date of publication and are subject to change.

#### WHERE ISSUED BY DIMENSIONAL IRELAND LIMITED

Issued by Dimensional Ireland Limited (Dimensional Ireland), with registered office 3 Dublin Landings, North Wall Quay, Dublin 1, Ireland. Dimensional Ireland is regulated by the Central Bank of Ireland (Registration No. C185067).

#### WHERE ISSUED BY DIMENSIONAL FUND ADVISORS LTD.

Issued by Dimensional Fund Advisors Ltd. (Dimensional UK), 20 Triton Street, Regent's Place, London, NW1 3BF. Dimensional UK is authorised and regulated by the Financial Conduct Authority (FCA) - Firm Reference No. 150100.

Dimensional UK and Dimensional Ireland do not give financial advice. You are responsible for deciding whether an investment is suitable for your personal circumstances, and we recommend that a financial adviser helps you with that decision.

Dimensional UK and Dimensional Ireland issue information and materials in English and may also issue information and materials in certain other languages. The recipient's continued acceptance of information and materials from Dimensional UK and Dimensional Ireland will constitute the recipient's consent to be provided with such information and materials, where relevant, in more than one language.

NOTICE TO INVESTORS IN SWITZERLAND: This is advertising material.

#### JAPAN

For Institutional Investors only.

This material is deemed to be issued by Dimensional Japan Ltd., which is regulated by the Financial Services Agency of Japan and is registered as a Financial Instruments Firm conducting Investment Management Business and Investment Advisory and Agency Business.

Dimensional Japan Ltd.

Director of Kanto Local Finance Bureau (FIBO) No. 2683

Membership: Japan Investment Advisers Association

#### SINGAPORE

This material is deemed to be issued by Dimensional Fund Advisors Pte. Ltd., which is regulated by the Monetary Authority of Singapore and holds a capital markets services license for fund management.

This advertisement has not been reviewed by the Monetary Authority of Singapore and should not be shown to prospective retail investors.

#### FOR PROFESSIONAL INVESTORS IN HONG KONG

This material is deemed to be issued by Dimensional Hong Kong Limited (CE No. BJE760) ("Dimensional Hong Kong"), which is licensed by the Securities and Futures Commission to conduct Type 1 (dealing in securities) regulated activities only and does not provide asset management services.

This material should only be provided to "professional investors" (as defined in the Securities and Futures Ordinance [Chapter 571 of the Laws of Hong Kong] and its subsidiary legislation) and is not for use with the public. This material is not intended to constitute and does not constitute marketing of the services of Dimensional Hong Kong or its affiliates to the public of Hong Kong. When provided to prospective investors, this material forms part of, and must be provided together with, applicable fund offering materials. This material must not be provided to prospective investors on a standalone basis. Before acting on any information in this material, you should consider whether it is suitable for your particular circumstances and, if appropriate, seek professional advice.

Neither Dimensional Hong Kong nor its affiliates shall be responsible or held responsible for any content prepared by financial advisors. Financial advisors in Hong Kong shall not actively market the services of Dimensional Hong Kong or its affiliates to the Hong Kong public.

[dimensional.com](https://dimensional.com)

