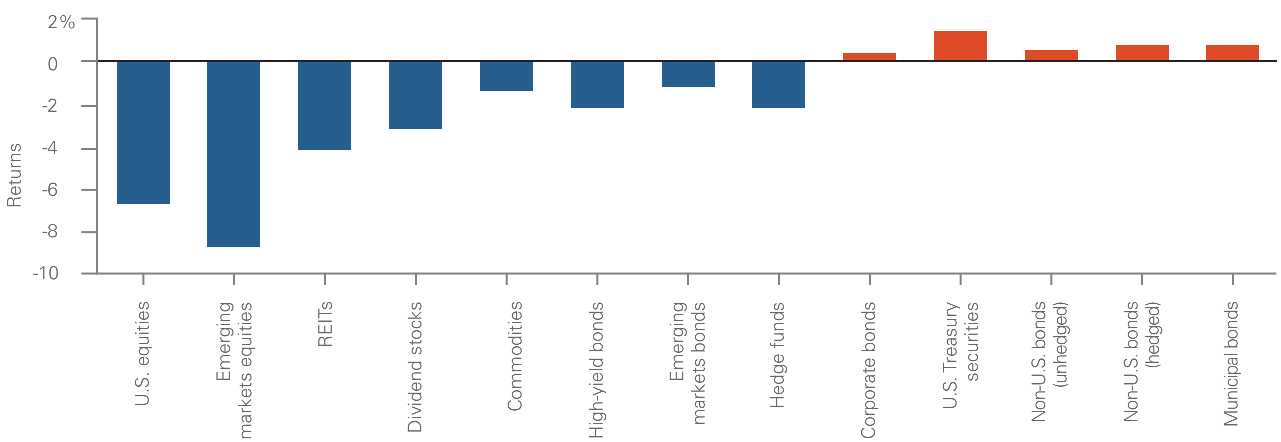
Downside protection when investors need it the most

Seeking diversification to help mitigate the effect of volatility on their portfolios, investors often consider real estate investment trusts (REITs), commodities, and hedge funds, but they overlook high-quality bonds,* which just might be the Rodney Dangerfields of the investment world. They don't get any respect.

The chart below demonstrates various investments' track records during turbulent periods for equity markets. By sorting monthly equity returns into deciles and examining the worst periods, we find that high-quality bonds have proved to be one of the best diversifiers for a portfolio.

Bonds can provide ballast in an equity bear market



Sources: Vanguard calculations, using data from FactSet; Morningstar, Inc.; and Barclays. All data through December 31, 2016.

Notes: U.S. stocks represented by Dow Jones Wilshire 5000 Index through April 2005, MSCI US Broad Market Index through June 2013, and CRSP US Total Market Index thereafter; emerging markets stocks are represented by MSCI Emerging Markets Index; REITs by FTSE NAREIT All Equity REITs Index; dividend stocks by Dow Jones U.S. Select Dividend Index; commodities by S&P GSCI; high-yield bonds by Bloomberg Barclays U.S. Corporate High Yield Bond Index; emerging markets bonds by Bloomberg Barclays Emerging Markets USD Aggregate Bond Index; investment-grade corporate bonds by Bloomberg Barclays U.S. Corporate Bond Index; U.S. Treasury bonds by Bloomberg Barclays U.S. Treasury Index; hedge funds by HFRI Fund Weighted Total Return Index; and international bonds by Bloomberg Barclays Global Aggregate ex-USD Bond Index. The Dow Jones U.S. Select Dividend Index starts in January 1992; the Bloomberg Barclays Emerging Markets USD Aggregate Bond Index starts in January 1993; the hedge fund data start in 1994; and the Bloomberg Barclays Global Aggregate ex USD Bond Index starts in January 1990. Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

All investing is subject to risk, including the possible loss of the money you invest.

Investments in bond funds are subject to interest rate, credit, and inflation risk.

Diversification does not ensure a profit or protect against a loss.

The bottom line:

High-quality bonds remain effective portfolio diversifiers, especially during sharp equity market declines, and they deserve more respect.

*A bond whose credit quality is considered to be among the highest by independent bond-rating agencies.