



Investing in Bonds

Fixed income investments have a place in most individuals' investment portfolios. Bonds or other types of fixed income investments provide diversification and predictable income and are generally thought of as more conservative investments than stocks.

Different Types of Bonds

Certificates of Deposit or Savings Certificates

Issued by banks, thrifts and credit unions, these instruments are probably the easiest to buy and own. They are often available in maturities ranging from 30 days to over five years. Since they are insured by the FDIC or NCUA up to \$250,000, the risk of default is almost nonexistent.

US Government bonds

The Federal Government also issues bonds of varying maturities. Treasury bills are issued with maturities of less than a year. Treasury notes have maturities from one to ten years and Treasury bonds have maturities from ten to thirty years. US Treasury obligations are considered to be some of the most financially sound investments available. Even though the risk of default is negligible, the values of these bonds change as interest rates change. When rates rise, values fall and vice versa. The longer the maturity, the more their values will change with changing interest rates.

Municipal bonds

Most obligations issued by states, cities and other non-federal governmental bodies pay interest that is not subject to federal income tax. As such, the interest rates on those bonds are usually lower than similar quality and similar maturity taxable bonds. To determine if tax-free municipal bonds are right for you, compare the after tax yield of a similar taxable bond with the tax-free yield of a municipal bond.

Not all tax-free bonds are of equal quality. Ratings agencies assign quality ratings to many bond issues. They look at the credit worthiness of the issuer and other factors. Usually it is a good idea to stay with high quality bonds - those rated A, AA or AAA. The market values of municipal bonds also change with changes in interest rates.

Corporate bonds

Corporations also borrow money by issuing bonds. The interest from these bonds is fully subject to federal and state income taxes. The ratings agencies also usually assign ratings to corporate bonds and staying with the high quality bonds makes sense.

Ways of own bonds

Individual Bonds

You can buy individual bonds from many sources. Banks usually offer government

bonds and brokerage firms can sell all types of bonds. The biggest benefit to owning individual bonds is the ability to choose exactly what bonds you own. Most bonds send interest or you can have it deposited into your brokerage account.

Mutual Funds

With a fixed income mutual fund, you buy shares in a fund that owns a portfolio of different bonds. The bonds are selected by the portfolio manager who also monitors the bonds while they are in the fund. The portfolio manager has the ability to buy and sell bonds from the portfolio as he or she thinks the market is changing. For example, if the manager believes that interest rates are going to rise, he or she may replace longer-term bonds with shorter maturity bonds so there will be less price deterioration if rates rise.

The disadvantages of bond mutual funds include the costs of the fund and being subject to poor selections by the portfolio manager.

Unit Investment Trusts

Unit investment trusts (or UITs) are like a mutual fund in that you buy into a portfolio of bonds, but the portfolio remains static. Once the UIT is formed, the bonds stay in place until they mature. Usually the costs of a UIT are lower than a mutual fund but you give up the close monitoring that is part of the portfolio manager's duties with a mutual fund.

Words of Caution

Fixed income investments should be conservative tools used to lower overall portfolio risk and to produce steady streams of income. There is often a temptation to consider types of bonds or other fixed income investments that offer returns that seem very high compared to the alternatives. Stay with high quality issues bought from reputable institutions. When something seems too good to be true, it often is.

~ For more information about stocks and how to make them work for you, contact Emprise Bank's Trust and Investment Services Division at 316-383-4422.