

Office for Financial Success – Financial Tip of the Week A  
service of the Personal Financial Planning Department  
College of Human Environmental Sciences University of  
Missouri-Columbia  
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**Bonds. (We're not talking about baseball.)**

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The recent carnage in the stock market has increased interest in bonds as an investment category. While many corporations' bonds have also been hit hard in the current economic malaise, many writers point out that the difference between the yields on bonds and Treasury bonds has not been this great for half a century. This is even true for municipal bonds, that are generally free from federal and, sometimes, state and local income taxes. Why is this and what should you know?

Municipal bonds have a reputation for safety. Municipal bonds, for example, that are *general obligation* bonds, have the full taxing authority of the issuing government behind them. So why, then, are municipal bonds packing after-tax yields of 8%. (This is greater than the 7% after-tax yield on stocks since 1926.) The answer, unfortunately, rests in the fact that the municipal bond market is rather fragmented and that most issuers use bond insurers – the same insurers that have been beat-up in the mortgage meltdown.

According to Jason Zweig, of [The Wall Street Journal](#) (\$\$\$), another reason is the fact that many municipal bond mutual funds have invested in *tender option bonds* which take the bonds and create two separate products, the short-term fixed part and the long-term variable part. The long term variable part has examples where upwards of 50% of the value of the bonds has been lost in the past year.

So what's an investor to do?

First, do not purchase individual mutual bonds, unless you've substantial assets to invest. Most municipal bonds have face-values of \$5,000. Thus, an investor with \$100,000 would purchase 20 different municipal bonds with his/her money. One default or mistake could easily cost you 5% of your principal. On the other hand, investors could purchase municipal bond funds. In fact, investors with state/local income taxes can often find municipal bond funds that only have bonds from their state to take advantage of this additional "no-tax" benefit. (Guess what, New Jersey, New York, and California are high income tax states with the law favoring in-state bonds. Would you like your municipal bond portfolio to be only invested in one of these states at this time? I don't think so.)

Each time we think about investing in a mutual fund, remember to do some simple things:

- Try to only consider bond mutual funds with annual expense ratios of less than 0.5%, or lower. For stock funds, the threshold can be raised to 1%.
- Read the prospectus. Better yet, download it from the web, and then read it – first with the "find" option on your document editor. Look for key words:
  - *Tender*
  - *Option*
  - *Bond*

- *Derivative*
- *Inverse*
- *Ratings* – see what the prospectus says are the “ratings” of these bonds. Remember BBB, or greater, are investment grade bonds. BB, or lower, are “junk” bonds.
- Make sure you know the *expense ratio* and that it is within reason (0.5%, or less, for bond funds)
- *Turnover ratio* should be 50% or less. More than 50% for a bond fund is excessive and adds to the funds internal costs which are passed on to the investor.
- Try to stick with fund families with stalwart reputations; Vanguard, T. Rowe Price, PIMCO, among others.
- Finally, read and study more about personal finance. Seek out programs offered by your local [Extension](#) office, [on-line courses](#) or informative websites, community college coursework, adult education programs, or your local university.

Yes, there appears to be investment opportunities in today’s market – a market that has slowed many a person’s quest for financial success. Look at these opportunities but do your homework and seek more information. While many people can manage their personal finances without the aid of paid assistance, others need assistance to help wade through the details of today’s investing world. If you’re one of these, pay someone to help you. Success rarely comes to one who sits and waits on her. Success prefers those who pursue her.

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