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# Financial Briefs

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## Myths about Bonds

Bonds are a core part of many people's investment portfolios. But that doesn't mean they're widely understood. In fact, there are many common myths about bonds, and following those myths could lead to poor investment decisions.

Below, we debunk a few of the most common myths about bonds.

**Myth 1: Bonds Are Risk-Free Investments**

It's true that investing in bonds is not as risky as some investments, like stocks or real estate. But less risk doesn't equate to no risk. A bond issuer may default on their obligations, which could leave investors without their principal.

Also, some bonds are riskier than others. Treasury bonds, which are guaranteed by the U.S. government, carry relatively little risk — the U.S. has never defaulted on its debt obligations. Corporate bonds, which are issued by companies, are generally riskier than government bonds.

You can get an idea of the relative risk of a certain bond by reviewing its bond rating, which is expressed as a letter grade. A triple-A bond means the issuer is extremely likely to meet its commitments. A bond with a C rating means the issuer is vulnerable.

**Myth 2: Lower Returns Mean Investing in Bonds Isn't Worth It**

Bonds may not be as glamorous as stocks and other investments, but that doesn't mean they don't have a place in your investment portfolio. Bonds are a way to add diversification to your portfolio; a stock-heavy portfolio can earn great returns, but it can also lose a lot of money fast if the market drops. Your stocks may eventually regain their losses; but if you need the money in the interim, you'll need to find other resources.

Bonds can also provide a steady source of income, which may be appealing if you're at a point when you would like to live off investment income. They are also a way to preserve your capital while still earning some returns.

In addition, certain types of bonds offer tax advantages — income earned on municipal bonds is free of federal income tax and sometimes state and/or local income taxes, for example.

**Myth 3: Bonds and Bond Funds Are Essentially the Same**

Not exactly. In some ways, the difference between individual bonds and bond funds is similar to the difference between individual stocks and stock mutual funds. Like a stock mutual fund, with a bond

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## Bonds at Every Stage of Life

Many think bonds are for the very conservative investor. But actually, bonds are an important component of a well-balanced portfolio throughout every stage of an investor's life. They can provide stability during volatile markets, provide an income stream, help with tax liability, and provide higher rates of return for capital growth. Regardless of your life stage, you should consider having bonds in your investment portfolio.

**At the Beginning**

As a beginning investor in your 20s or 30s, you have a long time to maximize capital and are probably in the best position to assume risks for larger returns. Even at this early stage of investing, you should develop a portfolio that also balances risk and market volatility. While higher-yield investments are important, you will still want to balance them with some lower-risk investments, including bonds. At this

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## Myths about Bonds

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fund, you give your money to a professional investment manager, who chooses a range of bond investments on your behalf.

With an individual bond, you have an investment in a single bond, which you hold until the bond's maturity date. Individual bonds have fixed payments, often semiannually or quarterly; and if you hold the bond to maturity, you'll get your original investment back.

On the other hand, bond funds have fluctuating income based on how well the underlying bond investments perform. Bond funds are more liquid than individual bonds, however, which means it's easier to sell your investment if you need the cash.

You'll also need to invest in a greater array of individual bonds to diversify the bond portion of your portfolio. Which bonds are right for you depends on your goals, comfort level with investing, and other factors.

**Myth 4: All Bonds Are Safe Investments**

First, it's important to understand there are no guarantees when it comes to investing — there's always risk. While bonds are generally considered less risky than stocks, that doesn't mean there's no risk, and some bonds are riskier than others.

Bonds issued by the U.S. Federal government carry minimal risk (for example, savings bonds or Treasury bonds). But similar bonds issued by a less-stable country or government could carry much more risk. State and local bonds (called munis) come with a greater risk of default than bonds issued by the U.S. federal government. Corporate bonds can be risky too, especially so-called junk bonds.

Want to get more of the facts on bonds? Please call to discuss bonds in more detail.

# Are All Triple-A Bonds the Same?

Unlike stock investors, those who invest in bonds usually have a way to gauge how risky an investment might be. It's the rating assigned to the bond by a credit rating agency, with triple-A being the agency's best rating.

However, not every triple-A rating means precisely the same thing. In fact, two bonds with that same rating can present different possibilities regarding timely repayment of principal.

Here's why:

- **The ratings are relative to the sector.** A fundamental fact bond investors must remember is the three major bond sectors each present different levels of risk completely apart from the rating each bond carries.

  In general, from the safest to the riskiest, the bond sectors are Treasuries, municipals, and corporates. Ratings agencies like Moody's and Standard & Poor's, two of the largest companies in the bond rating business, use the same scale for every bond sector.

  Each sector has a list of triple-A rated bonds, but that doesn't mean a triple-A rated Treasury poses the same level of risk as a triple-A muni or corporate does. The same goes for each rating and category.
- **Ratings are opinions.** Financial ratings are opinions and, as such, are as much art as science. Ratings are based on a careful review of the numbers, and each rating agency has its own general guidelines for which numbers go with which rating. Opinions can vary not only between credit agencies but even between different analysts within the same agency.

  After all, no one is perfect when it comes to predicting the future, and that's what ratings are supposed to do.
- **The issuers pay for ratings.** Agencies make their money from the fees they charge bond issuers. Ostensibly, they are able to command the respect of the marketplace by remaining objective, despite the potential for this arrangement to affect their judgment.

  Nevertheless, the outcry over toxic mortgage-backed securities, many of which were rated triple-A, has cast a shadow of doubt over how objective rating agencies may or may not always be.
- **Things change.** In all fairness to rating agencies, our global economic and financial systems are incredibly fast-changing. Knowing that, agencies try to keep up and often come out with new ratings as issuers' circumstances change, either for the worse or the better.

  Credit downgrades and upgrades are quite common, but with tens of thousands of bond issuers, the agencies can't keep up with changes in every issuer's circumstances.
- **Bond insurance can mask problems.** It's not uncommon for issuers of municipal bonds to secure bond insurance. In that case, the bonds assume the credit rating of the bond insurance company, regardless of the condition of the issuer's finances.

  If times got tough for state and city governments and a large number of them were to get financially weaker, it may be beyond the wherewithal of the municipal bond insurance industry to make every bond investor whole, in spite of its high rating.

While bond ratings are generally reliable, remember you have to look deeper than a bond rating to understand just how much risk it may pose to your portfolio.

## Bonds at Every Stage

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stage, you can:

- **Grow capital** with bonds that offer higher yields if you assume higher risk. Although higher-risk bond investments have potential for loss because of interest rate and credit risk, they are typically still a safer investment than equities. Make sure you understand the terms and conditions, including the bond's rating, call features, and if it is insured.
- **Protect your savings** for a large purchase, such as a car, wedding, or house. Lower-risk bonds can be a better investment than a traditional savings account to save for large purchases. Bonds will pay a higher interest rate and offer a safe way to protect your savings. You may want to consider Treasury or corporate bonds with maturity dates that align with the time frame in which you will need the money.
- **Diversify your employer-sponsored retirement plan** such as a 401(k). Your plan most likely offers a variety of mutual funds, and bond funds are a good way to diversify your portfolio and spread risk. The stock and bond markets do not typically move in the same direction, so bonds can stabilize and help with your overall returns.

**In the Middle**

Your mid-30s to late 40s should be a time of accumulating wealth and investing for retirement and other long-term goals. At this point in your life, you should rebalance your portfolio on a regular basis to ensure your allocation is keeping pace with your goals. Many experts agree that at this point, you should consider more medium-risk investments in combination with higher-risk investments.

Bonds should become a larger portion of your asset allocation than when you were younger, because they offer more predictable income and continue to balance higher-risk equities.

Following are some bonds to consider at this stage in your investment life:

- **Tax-advantaged bond investing** is a good way to help offset taxes if you're in a higher tax bracket. Municipal bonds, which are issued by state and local governments, are an attractive investment in your income-earning years because they are exempt from federal income taxes. And if you live in the same state as the issuer, they are free from state and local taxes as well. In most cases, you should not include this type of investment in a tax-deferred retirement or college savings account, because the tax-exemption feature will be wasted.
- **Zero-coupon bonds can be a good cost-effective investment for specific goals,** such as college or retirement. They are sold at a steep discount from their face value; and when they mature, the face value will include both the principal and any accumulated interest. These bonds also work well in a tax-deferred account because the interest is taxable when it is credited to the bond but you can't spend it until the bond matures.

**Approaching Retirement**

Now that you're getting closer to retirement, you will want to take fewer chances of losing a portion of your portfolio. Many experts recommend at this point, you should begin increasing the bond portion of your portfolio to 50% or more to lower your risk.

Some issues to consider when evaluating bonds for your portfolio:

- **Managing interest rate risk** is important because when interest rates rise, bond prices fall, and vice versa. One way to manage this risk is with a bond ladder. This strategy allows you to invest in a portfolio of bonds with different maturity time frames to help your investments do well in any interest rate environment. When rates rise, you will have short-term bonds maturing and can then invest the principal at higher rates. And when rates fall, you will have the longer-term bonds paying higher returns.

**In Retirement**

Now your main goal becomes protecting and maximizing your income for the remainder of your life. Social Security will most likely only replace a portion of your income, so your portfolio and any retirement benefits will need to make up the rest. Bonds will help generate retirement income while preserving your principal.

Things to consider:

- **Guard against inflation** because you are now living on a fixed income. Treasury Inflation Protection Securities (TIPS) or Treasury Inflation Indexed Securities will help guard against inflation. TIPS have a fixed coupon rate, but their principal amount is adjusted every six months according to changes in the consumer price index. When TIPS mature, you will get the higher of the original face value or the inflation-adjusted amount. You may also want to keep a small portion of your portfolio in stocks for growth potential.
- **Spend from taxable accounts first,** because when you withdraw from tax-deferred accounts, you will pay income tax on your distributions. By spending the tax-deferred accounts last, your portfolio will continue growing tax deferred while you are in retirement.

Please feel free to call if you would like to discuss bonds in more detail.

# News and Announcements

## From the Thurman Household

After many years of major health issues, my dad, Leo Thurman, went to be with the Lord on June 29. He passed away in his sleep. I thought I would list some of my dad's favorite sayings: 1. It don't take long to live a lifetime. (The last three years, his favorite saying) 2. If you dance, you gotta pay the fiddler. (Generally, when I was younger and trying to get out of doing something) 3. Be nice or nobody will like you. (Usually to health care professionals, who, on occasion, were in a grumpy mood) 4. That will make you late for the dance. (When something big happens that's going to take a lot of time.) 5. God only made one perfect person, and I'm not him. 6. I've got a story for that. (for pretty much everything) 7. There's a Jack for every Jenny, and a Jenny for every Jack. (When single people share how hard it is to find a significant other) 8. No matter how much lipstick you put on a pig, it's still ugly. (When I was younger, usually when I was trying to justify something I did) 9. Let me show ya how to do it. (Often, for he had a world of wisdom.)

Our son, Levi, is doing well. He's coming off of a 4.0 semester. We are expecting he graduates with his Associate's degree next semester.

Until next time…

*Randy Thurman, CFP®, CPA/PFS*

## From the Flinton Household

*"Every time I see an adult on a bicycle, I no longer despair for the future of the human race."* ~ H.G. Wells

On our vacation to Florida this year, we were transplanted to a time long past, where the primary mode of transportation was by bicycle. As we meandered through the cobblestone streets lined with Magnolia trees and beautiful, fragrant flowers, we were reminded of the simple pleasures in life. We were full of joy as we pedaled pleasurably alongside babbling brooks and natural wildlife. In recognizing a trail through the beautiful woods connecting two sections of the town, I thought it would be a fun time to take our talents down some beautiful trails of crushed granite and stone. Our daughter, Emerson, being six, was having some difficulty in traversing the unstable ground and gentle hills, so I took to a life lesson shrouded in bicycling tips. I talked about pedaling hard enough to gain momentum, and how the momentum in life, I mean biking, will help carry you more easily and farther than without. Like *The Little Engine That Could*, she pumped her little legs furiously up the hill, and screamed in delight "I have momentum!" as she reached the crest and started a descent that we weren't expecting. It was at that moment that I realized I should have discussed braking down a grade. She was over the handle bars and sliding on her face before we knew it. We learned valuable lessons that day; that in life, it's not how hard you fall, but how quickly you get back up, that momentum can work for or against you, and that dad no longer gets to lead when we're riding bikes.

Have a wonderful month,

*Andrew Flinton, CFP®*

## From the Rudy Household

Prior to my career change to financial planning, I worked in information technology. While I had varied roles in the technology industry, my emphasis was on business application development. While at work, I greatly enjoyed studying processes and finding ways to streamline flows with computer automation. However, once I was at home, the last thing I wanted to do was spend another moment at a computer.

Over the past decade, that has definitely changed to the point that technology has become my hobby. I really enjoy researching all the new tech gadgets and services that come to market. One of my favorite projects was comparing the varied music streaming providers. I'm embarrassed to admit that I had a subscription at one time to nearly every one of the music providers, "in the name of research."

With all the fun I am having, I also find many productive uses. Most recently, I moved our 1TB+ (for non-techies, that is a big number) family video and photo library to the cloud. Since my daughters can now access the library from their phones, they enjoy embarrassing each other by sharing childhood pictures with friends. For business use in financial planning, I am continually evaluating the myriad of applications and services available in the market.

I do enjoy my tech hobby, but at the end of the day, I appreciate it even more when the outcomes are productive.

*Chad Rudy, CFP®*