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left to right: Joe Bowie, Andrew Flinton, Brenda C. Bolander, Carol Ringrose Alexander, Randy Thurman, and Chad Rudy

Financial Briefs

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Diversifying Your Bond Portfolio

Most investors understand the benefit of diversifying their stock portfolios: it's a matter of spreading your risk. But does the same principle apply to a bond portfolio? The simple answer is yes.

Bonds carry risk. As an asset class, bonds pose less risk than stocks for the simple reason that if and when an issuer goes out of business, bondholders take precedence over stockholders when it comes to distributing assets.

Here, we're talking about credit risk — just one of the several different kinds of risk bond investors face. It's impossible to eliminate this risk entirely from any bond portfolio: companies go out of business and pay bondholders pennies on the dollar, and governments — even sovereign national governments — can run into financial trouble and pay out later than scheduled or renegotiate their debt on terms that are less favorable to investors.

U.S. Treasuries' Safety Comes at a Cost

When it comes to credit risk, the outlier is U.S. Treasuries: Treasury bills, bonds, and notes. Backed by what is still regarded as the strongest, most stable government in the world, U.S. Treasury securities are considered the safest choice for receipt of timely interest payments and 100% redemption. So Treasuries remain bond investors' best choice for minimizing the chances that they won't receive redemptions at the bonds' face value.

But because Treasuries are the safest bonds out there, they come with a downside: across the maturity spectrum, the interest rates Treasury securities pay are among the lowest you'll find. In other words, you trade income for safety — and not having the income you need to meet your goals has to be considered a risk.

So why diversify away from Treasury bonds? Not to control risk better, but to achieve higher income. And that's the principal reason for diversifying your bond portfolio: to achieve a better balance between risk and reward to match your needs and objectives.

There are basically three dimensions of bond diversification: issuer, credit quality, and maturity.

Different Issuers, Different Risks and Rewards

There are five major sectors of the bond market, and they're defined by the class of issuer. Each poses a different risk/reward profile. As in all financial markets, the lower risk you want, the lower your potential rate of return; to get a

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Incorporating Bonds into Your Portfolio

When selecting investments for your portfolio, you should custom fit your investments to your personal situation and specific financial goals. By taking the time to consider certain specifics about bond investing, you can determine the appropriate way to include bonds in your portfolio, which will help you pursue your short- and long-term financial objectives.

Identify your investment goals. Your investment goals will help determine the role bonds should play in your portfolio. Investors focused on long-term growth and capital appreciation with no need for current income will have less need for bonds. On the other hand, investors looking for a balance of income and capital appreciation will have more bonds in their portfolios. Investors primarily interested in interest income will have a significant portion of their portfolios devoted to bonds.

Determine your risk tolerance. Typically, the higher a bond's return, the greater its risk. Thus, U.S. Treasury securities, which are considered one of the safest bonds, typically carry lower interest rates

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Diversifying Your Bond

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higher level of return, you must typically take on more risk. In ascending order of reward, the sectors are:

- **U.S. Treasuries.** Backed by the federal government's authority to print money and the U.S. economy's long-term history of moderate to low inflation, Treasuries offer the highest level of safety and the lowest yield.
- **Federal agency bonds.** These include bonds issued by mortgage agencies backed by the federal government, including Ginnie Mae, Fannie Mae, and Freddie Mac. Historically, these bonds pay higher yields than same-maturity Treasuries, since none of these agencies are backed by the full faith and credit of the U.S. Treasury. (While the federal government did bail out bondholders in 2008 following the collapse of the mortgage-backed bond market, there is no guarantee that in the future the same thing will happen.)
- **Municipal bonds.** These are issued by nonfederal governments and agencies. Because they have the legal power to tax or charge fees, as an asset sub-class they are regarded as second to Treasuries in safety. As a result, they can pay a higher after-tax rate of return than other types of bonds. Because the income they generate is usually exempt from federal and sometimes state and local income taxes, investors in higher tax brackets can earn higher after-tax income than they can from other types of bonds.
- **Corporate bonds.** These actually fall into two categories: investment-grade or high-quality corporate bonds and high-yield corporate bonds, also known as junk bonds. Corporate bonds offer higher yields than Treasuries or municipal bonds; but because their issuers are business enterprises, they present more risk. Junk bonds offer the highest yields but are issued by companies in financial distress — those that pose a greater risk of going out of business before the bonds mature.
- **Foreign bonds.** This is really a sprawling category of issuers, since it includes national governments and corporations and countries in both the developed world and emerging markets. The common additional risk element across all these subcategories is currency risk — the possibility the value of the foreign currencies will fall against the dollar, reducing the relative value of the bond.

Riskier Credit and Longer Maturities Mean Higher Yields

The lower the credit ratings and the longer you go out in maturity, the higher the interest rates you'll find. That's because there are greater risks an issuer won't be able to make its payments or inflation and interest rates will be higher and bondholders will be stuck with below-market yields.

The purpose of diversification in both stocks and bonds is to fine-tune the trade-offs investors make between risk and reward potential. With interest rates near historic lows, many bond investors have been tempted to reach for higher yield by taking on more risk in the form of lower-rated issuers and longer maturities.

With literally thousands of different bonds in the market, it's a significant task to find the best mix of issuer, credit, and maturity. Please call if you'd like to set up a portfolio review.

Consider Maturity Dates

Bonds can be purchased with maturity dates ranging from several weeks to several decades. Before deciding on a maturity date, review how that date affects investment risk and your ability to pursue your investment goals.

Typically, yield increases as the maturity date lengthens, since you assume more risk by holding a bond for a longer time. Investors are often tempted to purchase bonds with long maturity dates to lock in higher yields, but that strategy should be used with care. If you purchase a long-term bond knowing you'll need to sell before the maturity date, interest rate changes can significantly affect the bond's market value. Two fundamental concepts about bond investing apply:

- **Interest rates and bond prices move in opposite directions.** A bond's price rises when interest rates fall and declines when interest rates rise. The existing bond's price must change to provide the same yield to maturity as an equivalent, newly issued bond with prevailing interest rates. You can eliminate the effects of interest rate changes by holding the bond to maturity, when you will receive the full principal amount.
- **Bonds with longer maturities are more significantly affected by interest rate changes.** Since long-term bonds have a longer stream of interest payments that don't match current interest rates, the bond's price must change more to compensate for the interest rate change.

Although you can't control interest rate changes, you can limit the effects of those changes by selecting bonds with maturity dates close to when you'll need your principal. In many cases, you may not know exactly when that will be, but you should at least know whether you are investing for the short, intermediate, or long term.

Please call if you'd like to discuss bond maturities in more detail.

Incorporating Bonds

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than municipal or corporate bonds. Make sure you understand the risks involved before purchasing a specific bond.

Understand the tax ramifications. Different types of bonds are taxed differently. Interest income from U.S. Treasury securities is exempt from state and local income taxes but is subject to federal income taxes. Interest income from municipal bonds is exempt from federal income taxes and typically state and local income taxes for residents in the issuing state. Interest income from corporate bonds is subject to federal and state income taxes. Investors in higher marginal tax brackets typically find tax exemption of interest income more valuable. Any exemption from income taxes applies only to interest income, so capital gains from the sale of a bond are still subject to income taxes.

The role of bonds in your portfolio will depend on these variables. Please call if you'd like help evaluating bonds for your portfolio.

How Much is Enough?

By **Carol Ringrose Alexander, CFP®, AIF®, CDFA™**

According to Eric Weiner, author of *The Geography of Bliss*, "Money matters, but less than we think and not in the way that we think." Weiner, a National Public Radio foreign correspondent, traveled the world to find out why people who live in some places seem to be happier than others. He found that: "Family is important. So are friends. Envy is toxic. So is excessive thinking. Beaches are optional. Trust is not. Neither is gratitude."

He continues, "America's current fixation with finding happiness coincides with an era of unprecedented material prosperity… As early as the 1840s, Alexis de Tocqueville observed that America was populated by "so many lucky men, restless in the midst of their abundance."

"America's place on the happiness spectrum is not as high as you might think, given our superpower status," Weiner writes. "We are not, by any measure, the happiest nation on earth." One study ranked the United States as the world's 23rd happiest nation, behind countries such as Costa Rica, Malta, and Malaysia. "It's safe to say that the United States is not as happy as it is wealthy," he wrote.

"We are the wealthiest country in the world, the wealthiest nation ever," Weiner continues. "Basic survival is not an issue for most Americans. Wealthier Americans are on average (slightly) happier than poorer ones. Yet one fact bedevils the money-equals-happiness argument: As a nation, we are three times richer than we were in 1950, yet no happier. What is going on?

"Clearly, one dynamic at work is rising expectations. We compare ourselves not to the America of 1950 but the America of today and, more specifically, to our neighbors of today. We give lip service to the notion that money can't buy happiness but act as if it does. When asked what would improve the quality of their lives, Americans' number-one answer was money, according to a University of Michigan study.

"Money does indeed buy happiness. Up to a point. That point, though, is surprisingly low: about $15,000 a year. After that, the link between economic growth and happiness evaporates. Americans are on average three times wealthier than we were a half a century ago, yet we are no happier." The same is true of Japan and many other industrialized nations. Richard Layard, a professor at the London School of Economics, said, "They have become richer, they work much less, they have longer holidays, they travel more, they live longer, and they are healthier. But they are no happier."

I believe the critical question is, "How much is enough?" This applies to just about everything in our lives, from books and items of clothing, such as shoes, to our income. Once we determine the answer, we may find that we already have enough.

Wouldn't we all be happier if we carefully considered how much is enough? So while money is important, it isn't the key to happiness. Once we determine what is most important to each of us, focusing on the relationships and activities that enrich and enhance our lives will make a difference.

News and Announcements

From the Thurman Household

My son, Levi, has finished the semester with As and Bs. I'm proud of his effort. Particularly proud of his effort in Anatomy class. It has been a tough class with a tough instructor. When you see him, ask if he knows the bones in the wrist or something off the wall like that. He will happily tell you.

Having my mother-in-law's estate/garage sale this week. It's been a tough and timely endeavor. My wife, Pati, has put in a ton of time and effort into this. Sixty years of accumulation. That generation was certainly…frugal. There is lots of cool stuff. For example, thousands of books — some dating back to 1890, 48 star flags, cast-iron skillets, and antique furniture. And then there is other stuff. It's a shame we can't sell plastic and old, used paper by the ton easily.

I will be going to the four-day AICPA Advanced Personal Financial Planning conference in June. They moved it from January. If you would like a copy of my notes, just call the office.

My new book, *More Than a Millionaire*, is now in polishing mode. I hope to have it available this fall.

Make it a great month,

Randy Thurman, CFP®, CPA/PFS

From the Flinton Household

It took no time at all for my daughters Samantha and Emerson to fully embrace the summer break, and all the benefits that it entails. Summer always seems to come at the breaking point for everyone! We can once again catch our breath, sleep a little later, and stay up a little longer. Before we know it, the routine will begin again.

I tend to become pensive mid-summer as I reflect on the past year and how my girls have me scrambling to put the sand back into the hourglass. Being reflective and intentional with my family is easy, as my day-to-day work forces me into making 10-, 20-, even 30-year projections. I can't help but also project forward a vision of what the future may hold for my children in what will surely be a short time frame.

My wife tells me I am way too sappy, but it is hard not to be when you are acutely aware of how precious and fleeting time can be. My sentiments would be different if my profession wasn't what it is; but as you know, I sit with people daily who are living examples of how "it don't take long to live a lifetime."

Summer just began; and it a strange way, it feels like it is already coming to an end. For my part, I will continue to enjoy watching the sands pass through the hourglass while at the same time, trying to catch it and put it back in.

Have a wonderful summer,

Andrew Flinton, CFP®

From the Bolander Household

"Happiness is having a large, loving, caring, close-knit family…in another city."

~ George Burns

Summertime is family time, and we have several get-togethers planned, including traveling to Springfield, Missouri and Ada, Oklahoma. One benefit of getting out of town is drive-time conversations with our family to catch up on ideas and plans that otherwise get lost in the routines of daily living. It also provides time to "ponder." It would be easy to let everyone in the car just plug into their preferred entertainment device, but it's much more interesting to engage in conversation to consider, contemplate, deliberate, muse, and even wonder out loud with my favorite people.

Finding nonthreatening topics is easy. For example, just a few weeks ago, the "prize" in a kid's meal from a local restaurant chain was conversation questions, and some family board games have topics to discuss such as "Would You Rather" or "Apples to Apples." Just leave the board at home. Otherwise you can Google "conversation topics" before you go.

Of course, if the conversation lags, you can always revert to math problems as we did when I was a child traveling in my parents' car. (Dad was a math teacher.) Now, there are some memories for you!

Have a great summer,

Brenda C. Bolander, CFP®, CPA/PFS