



## Managing Your Money

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By JUDITH BEDELL

### Bonds a safe bet to stabilize investor portfolio managing your money

**Q** What is the difference between municipal bonds and government bonds?

**A** The opportunity that bonds give an investor is the opportunity to be free from worry. Why? Because bonds are predictable. They are the only investment opportunity that assures you for certain when you will get your capital return, the amount returned to you and how much interest you will be paid during the life of the bond. In other words, with bonds, you have a chance to be in control of your investments.

Municipal bonds, commonly known as munis, are bonds issued by a broad range of organizations, such as states, cities, counties and water districts. They issue bonds to pay for public projects considered essential services for the common good.

The interest the bonds pay to the investors is declared tax free to the investor because voters decided at the polls that the underlying projects or services were essential.

Muni bonds come in two flavors, with a coupon and zero-coupon. The zero-coupon muni bond is attractive for investors accumulating wealth for their retirement because the interest is withheld until the bond matures, giving the investor a known outcome during retirement years. On the other hand, a coupon bond actually pays you the interest twice a year. These coupon-paying muni bonds are well-suited for retirees who are living off the income from their investments.

You also asked about government bonds that are issued by the U.S. Treasury Department to finance projects and services. Unfortunately, some of these bond issues are used to pay interest on old bond issues and underwrite the federal government's spending more than it earns.

Government bonds are priced off the bellweather U.S. government bond, which is currently the one maturing in 10 years.

Today, that rate on the 10-year Treasury bond sits at about 4.5 percent. A normalized return on a 10-year Treasury would be about 5 percent; therefore, many bond investors are sitting on the sidelines today awaiting the return of the 5 percent yield.

**Q** Are high-yield bonds better investments than low-yield bonds?

**A** No. High-yield bonds are euphemistically referred to as junk bonds because they have low credit ratings.

It would be imprudent to invest in a junk bond unless you were willing to lose your capital or willing to lose your string of interest payments from the bond.

We strongly urge individual investors to avoid junk bonds and stick to investment-grade bonds, which are described as those bonds bearing a credit rating of BBB, A, AA or AAA.

We all use the expression "A-rated": A-rated car, A-rated team, A-rated quarterback, A-rated restaurant -- this is where the expression comes from. Being A-rated connotes being safe, reliable and of high quality, which is where most investors want to be.

**Q** With interest rates so low these days, how can I invest in bonds?

**A** Bonds give balance and stability to your investment portfolio. Any time you invest in something, you are taking some risk while seeking some reward.

For ages, bonds have been considered the foundation of a good portfolio; however, a bond portfolio is based on the prevailing interest rates at the time you buy the bond.

Same goes when you sell the bond. Today you will earn about 4.5 percent if you invest in the safest government bond that will mature 10 years from now. Therefore the risk in buying bonds now is called an "interest rate risk" because you may or may not be able to sell the bond for your purchase price if interest rates go up. This is the inverse

relationship between interest rates and bond prices.

In other words, if you buy a bond now, when the yield is at 4.5 percent, then sell it later when the yield is at 4 percent, you make a profit on bond sale in addition to earning the flow of interest payments while you owned the bond.

Conversely, if interest rates spiked from 4.5 percent to 5 percent and you had bought the bond today at 4.5 percent, the market value of your bond would decrease.

The big caveat, however, is this: If you hold the bond to maturity, you will receive face value; if you sell it any time in the interim years, you can either gain or lose depending on the vagary of interest rates going up and down.

To avoid interest rate risk, we craft a bond portfolio with differing maturity dates that preclude our having to sell a bond early. Such a technique is called bond laddering.

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