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Financial Briefs

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Bonds: Not Just for Retirement

Bonds can be a good investment alternative at all stages of your life, not just when you retire.

During Childhood

Savings bonds can be a way to teach children the importance of savings and growth. Though these bonds might not have the initial thrill of toys or cash, they can provide a unique opportunity to instill in young people the basics of saving and investing and even increase the probability that you'll raise financially savvy adults. The gift that keeps on giving, savings bonds will not only provide children with intermittent interest payments to either invest, save, or spend, but a sizeable return once their bonds mature during their college years and beyond.

In Your 20s

Once you enter your 20s, bonds may no longer hold the appeal they might have afforded you as a child, but they're still useful in a more grown-up way: retirement. Though most of your growth-centered retirement account will likely be in stocks, you might also consider a small allocation of bonds as an anchor that can provide some stability to your investments. After beginning your retirement contribution plan, focus on paying off student loans and building a savings account for emergencies. If you still have extra money to work with and you have a specific goal down the road, such as graduate school or saving for a down payment on a home, annual payments from a fixed-income investment such as bonds can help you reach your goals with minimal risk. Depending on the type of bond you purchase, bonds don't come with early withdrawal penalties should you run into an emergency.

In Your 30s and 40s

Though it may seem a lifetime away, you're now a decade or two closer to retirement, so it's time to rethink your asset allocation. Even though you're more likely to be serious about investing and retirement — perhaps opening an IRA or increasing your 401(k) contributions with raises or bonuses — you may want to rethink your risk tolerance, even if you're just getting started in

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4 Reasons to Invest in Bonds

Bonds have a reputation as safe, stable investments. But writing off bonds as boring investments that are best for the risk-averse could be a mistake.

While it's true that investing in bonds tends to lack the dramatic highs (and the lows) that come with investing in stocks, that doesn't mean you should ignore the opportunities bonds present. Here are four reasons why you might want to have a portion of your portfolio in bonds.

1. Bonds are a way to diversify your portfolio.

Many financial experts recommend diversifying your portfolio to include a variety of asset classes, including bonds. This is a concept known as asset class diversification. Because different asset classes tend to perform differently at different times, you may be able to create a portfolio that generates more stable returns by investing across asset classes. For example, stocks and bonds tend to historically move in opposite directions, which means that owning some of both can help smooth out the ups and downs in your portfolio.

2. Bonds are (usually) less risky than equities.

If you are looking to dial-down risk in your investment portfolio, increasing your allocation to bonds may be one way to do that. However, keep in mind that less risky

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Not Just for Retirement

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the investment arena. Should the market happen to take a downturn and you're still entirely invested in stocks, you no longer have as much time to recover, particularly if you plan on retiring younger. Bonds can lend more security to your portfolio, allowing you to work toward financial goals in a less risky way.

By now, you may have also inherited money from a grandparent, great uncle, or even parent. If you'd like to invest this money for a specific goal down the road, such as your children's college education or a kitchen remodel, individual bonds can provide you with semiannual interest payments, and depending on the bond type and grade, a guaranteed total return.

Approaching Retirement

Now that you're inching closer to retirement, it may be time to take a more conservative approach with your investments rather than exposing them to the volatility of the stock market. Whereas before you might have been more aggressive with your portfolio growth, you may want to consider protecting what you've worked so hard to establish by transitioning a larger portion of your portfolio to bonds.

Beyond retirement planning, bonds can now help you reach specific goals, such as funding a new grandchild's college education down the road or achieving your dream of a vacation home in the tropics. Because bonds come with a variety of maturity dates — whether your goals are approaching in 20, 10, or even five years — bonds can help achieve them, with less risk than stocks but most likely a better return than the savings account at your credit union.

Your Golden Years

Collecting your Social Security benefits is one thing, but you may not be as thrilled about taking distributions that might dip into your retirement principal. This can be an ideal time to begin focusing predominately on bonds, which can offer numerous advantages throughout your retirement years. At this point in your life, the goal is to retain your principal as long as possible, since it's impossible to predict how long you'll live. Additionally, the more you can preserve in the long run, the more you can leave to loved ones when you die. You'll need an investment plan that maximizes your retirement accounts by affording you with enough interest to live comfortably without liquidating your principal. Because your income is likely entirely dependent on Social Security benefits and investments, it may not be prudent to expose your retirement funds to the volatility of the stock market. A bond fund can provide enough interest to subsidize your income while preserving enough of your principal to outperform inflation. Furthermore, tax-exempt municipal bonds can help shelter you from a higher tax bracket.

The best financial strategy at any age is an asset allocation tailored specifically to your personal goals and risk tolerance. Please call to discuss this in more detail.

Bond Investing Tips

- **Determine your objectives before investing.** Decide how much of your portfolio you want invested in bonds.
- **Diversify your bond holdings among different bond types.** Consider government, corporate, and municipal bonds, as well as different industries, credit ratings, and maturities.
- **Understand the risks that affect bonds.** The most significant risk is interest rate risk. When interest rates rise, bond values fall, while values rise when interest rates decline. Other risks include default risk, or the possibility the issuer will redeem the bond before maturity; and inflation risk, or the possibility that inflation will outpace the bond's return.
- **Choose bond maturity dates carefully.** When you need your principal is a major factor, but the current interest rate environment may also affect your decision. Rather than investing in one maturity, you may want to stagger or ladder the maturity dates in your portfolio.
- **Follow interest rate trends.** At a minimum, follow the prime rate, Treasury bill rates, and Treasury bond rates. Understand the significance of the yield curve and track its pattern over time. By monitoring current interest rate levels, you will be able to evaluate the appropriateness of an interest rate for a specific security.
- **Compare interest rates for specific bonds before investing.** Interest rates can vary substantially among different bond types and among bonds with different maturities or credit ratings.
- **Research a bond before purchase.** Review the credit quality, coupon rate, call provisions, and other significant factors. Determine whether the bond is appropriate for you in terms of risk, return, and maturity date.
- **Consider the tax aspects.** By comparing the after-tax rate of return for various types of bonds, you may be able to increase your return. Depending on the bond, the interest income may be fully taxable or exempt from federal and/or state income taxes.
- **Review your bond holdings periodically.** Evaluate the credit ratings of all your bonds at least annually to ensure the quality hasn't deteriorated. Also, ensure your holdings are still consistent with your overall investment objectives and asset allocation plan.
- **Call for assistance with your bond holdings.** You should use carefully designed strategies to make bond decisions. Please call if you need help.

4 Reasons

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doesn't mean risk free. Bond issuers can default. You also face inflation risk. Because bond payments are set in advance (that's why they're known as fixed-income investments), you lose purchasing power due to inflation.

3. Bonds can provide a steady, predictable source of income.

Stocks and other investments are unpredictable — you don't know with any certainty how well a given stock might perform in a certain year or even how well certain types of stocks (like small-cap stocks or international stocks) will do. Bonds are a bit different. They are debt investments, which means you are essentially agreeing to loan an entity, like the government or a corporation, money for a certain period of time. The entity you are lending money to agrees to pay you a certain amount of interest (known as the coupon) over the time they have your money, plus repay your initial investment when the bond reaches maturity. That means that unlike some other investments, you have a pretty good idea of how much money you're going to see from your bond investments over the years.

Of course, bonds aren't risk free. Bond issuers can default, and you could lose your money. That's why riskier bond issuers tend to offer investors higher coupon rates — their greater risk is compensated by greater total return. But in general, bonds are more predictable in how much money they generate for investors, which is one reason why they're so appealing to retirees.

4. Bonds can provide valuable tax savings.

Depending on the types of bonds you own, you may be able to save on taxes. While you'll pay normal taxes on corporate bonds, income from Treasury bonds (which are issued by the U.S. federal government) is free of state and local tax. Then there are municipal bonds, or bonds issued by state and local governments. You won't pay federal tax on money you earn on these investments, and you may also be exempt from state and local tax. For anyone who is looking to minimize their tax burden, especially retirees, this can be an appealing proposition.

Questions about making bonds part of your investment strategy? Please call to discuss this topic in more detail.

Are All Triple-A Bonds Alike?

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:

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

2. 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. And after all, no one is perfect when it comes to predicting the future, and that's what ratings are supposed to do.

3. The issuers pay for ratings. The rating agencies make their money from the fees they charge bond issuers. Ostensibly, the agencies 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 just how objective the rating agencies may or may not always be.

4. Things change. In all fairness to the rating agencies, our global economic and financial systems are incredibly fast-changing. Knowing that, the 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.

5. 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 state 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.

News and Announcements

From the Thurman Household

My mom went to be with the Lord last month. She passed away in her sleep. I talked to her on the phone the night before and she was in good spirits but very sleepy. She had health issues but this was unexpected. Our last words to each other were "I love you" and "bye." A pretty good way to go. A friend sent me these words that I found comforting and I wanted to share with you:

When Tomorrow Starts Without Me

by David Romano

When tomorrow starts without me,

please try to understand

That an angel came and called my name,

and took me by the hand;

The angel said my place was ready,

In Heaven far above,

And that I'd have to leave behind

All those I dearly love.

But when I walked through Heaven's Gates,

I felt so much at home,

For God looked down, smiled at me,

And told me, "Welcome Home."

So when tomorrow starts without me,

Don't think we're far apart,

For every time you think of me,

I'm right there in your heart.

Make it a great month!

Randy Thurman, CFP®, CPA/PFS

From the Rudy Household

Early this summer, my wife Amy and I celebrated our 25th wedding anniversary. We are taking a vacation with our family next summer to celebrate. But, at the last minute, we decided to take a trip now, just the two of us. We chose to travel somewhere we'd never been, Sedona, Arizona. After our flight into Phoenix, we rented a jeep and were on our way. Not having much time to plan this vacation, we stopped at the Arizona Visitor's Center. We took the advice of the Visitor Center volunteer and with a pile of maps and brochures in hand, we drove to Sedona on scenic highway 89A. The views of the Arizona landscape were stunning. However, I was personally very relieved to exit the winding mountain roads and arrive in Sedona.

The next morning, we took an open-air van tour of the city's famous landmarks. Our guide, a 23-year resident, was very knowledgeable about all aspects of Sedona and even knew the best spots to get the perfect photo. We were pleased to learn that many of his recommended sites and restaurants were already on our list that we'd created after looking through the brochures.

When it was time to head out of the city, back to the airport, we took a different route, the Red Rock Scenic Byway. We loved learning about the state of Arizona and the city of Sedona. The vibrant community and the unmatched natural beauty of the area gave us just the relaxing vacation we wanted.

Chad Rudy, CFP®

From the Bolander Household

In mid-July, my racing enthusiast brother-in-law made plans for the four of us to attend the Red Dirt Raceway's "Tuesday Night Thunder." The quarter-mile dirt track is just north of Meeker. It was a beautiful, cool evening for July and the recent rains kept the flying dirt and dust to a minimum. The event was a National Non-Wing Micro Sprint car (aka Midget) competition. These tiny cars are powered by 600cc motorcycle engines. The prize for the winner of the 30-lap race was $4,000. I was rooting for Muskogee's Kaylee Bryson in her pursuit to become the first woman to win a USAC National Midget feature. Kaylee was the leader for 11 laps, but midway through she got caught up in a three-car pileup that put her at the back of the pack. Another driver who had the quickest time in the heats ended his chances by flipping his car on the first lap when he sailed up and over the bank. The winner came from third place late in the race to capture the prize, 17-year-old Daison Pursely from Locust Grove, Oklahoma. It was his first national win though he's been racing for 2 years. We look forward to the next time we can get out to the track. Have a great month.

Brenda C. Bolander,
CFP®, CPA/PFS