LCBS-2024-03-20-WhatIsABond.pdf

DISCLAIMER - I am not a Financial Advisor and do not work for any Brokerage Firm. The opinions given are of my own and are not to be used as professional advice. These are my findings and can hopefully help you to make informed decisions on investing. Consult a Broker or Lawyer before making any investment.

All of us have to start somewhere with investing. I have found that you can be successful in investing by using bonds. Some people feel bonds are the only safe way to invest, but they only offer low rates compared with good years on the stock market. Let's look today at the financial instrument called Bonds.

BONDS

What are bonds and how do they differ from other financial instruments/categories such as Stocks, Mutual Funds, and ETFs? (Exchange Traded Funds.) Recently, we went over briefly those 3 categories. Today, let's discuss what bonds are and how they should be used in your portfolio.

WHAT IS A BOND

A bond in simple terms is a debt security. The entity issuing you the bond owes you money. Companies that issue bonds do it to raise money from investors with a promise to pay in a set time period at a fixed rate. (normally a fixed rate.).

The time period can be 1, 5, 10, 20, or 30 years. The issuer promises to pay you back the original value of your purchase plus the accrued interest based on the interest rate specified. If you purchased a $100 bond with a 10% rate for the period of one year, at the end of that year you should receive $110 which is the principal of $100 plus the interest of $10. Bonds typically make payments of interest twice per year, but not all do.

ADVANTAGES OF BONDS

They are obligations of the company, so obligations must normally be paid first in case of bankruptcy. If you buy high-rated bonds (AAA or AA), the chances of default are very slim. But not all Bonds are AAA. Many are B or B-

and some are considered junk bonds. Normally a bond yields a predictable income stream and they work well in a portfolio with stocks, mutual funds, and ETFs.

As the market dips and you lose 3% of your stock value in the stock market, many times the bonds will go up in value by 1 to 2% offsetting your losses on the stock. Until this year, 2022, that has always been the case in my portfolio. However in 2022, for whatever reason, the bonds have slipped some when the stock market went down. I have not dug into this anomaly, but I think it is related to the Fed upping interest rates during this time of high inflation. In prior years, my results have been that bonds move in opposite direction to the stock market, making them ideal instruments to hold.

A mix of 50% bonds and 50% stocks is considered a conservative mix, and if you are very young, you probably would want to stay more like 70% stocks and 30% bonds. Reasoning behind that is the stock market typically recovers from losses, and a young person can weather the long term effects. A person nearing retirement may want to hold 60% bonds and only 40% stock. Only you can assess your risk factor. This has to be assessed before making any investment in any kind of category.

KINDS OF BONDS

Corporate Bonds – those issued by private and public corporations.

High Yield Bonds – Those with lower credit rating making them have to pay a higher rate percentage.

Investment Grade Bonds – Less Credit risk associated with bonds in the upper high ratings. Typically AAA, AA, or A rating.

Municipal Bonds – These are issued by cities, counties, and states to finance the building of stadiums or other structures such as hospitals. Building of highways is often done with Revenue bonds and these are backed by the revenue from the specific project. Some bonds are NOT SECURED BY ASSETS. These are called General Obligation Bonds, which are a bit riskier.

US Treasuries – probably one of the safer long term investments are issued by the Department of Treasury and backed by the government. These have to date been consistent with no defaults. But the day may come where the

government may not can pay its obligations as our national debt is escalating at a very high rate.   But Treasury bills, Notes, and Treasury Bonds are considered safe investments.

Currently, you can open an account at TreasuryDirect.gov and purchase Inflation protected bonds (**I-Bonds**) that in March of 2024, are now paying an rate of 4.86%. (verify the current rate at TreasuryDirect.Gov.   This rate is guaranteed for six months and then resets to the new inflationary rate.

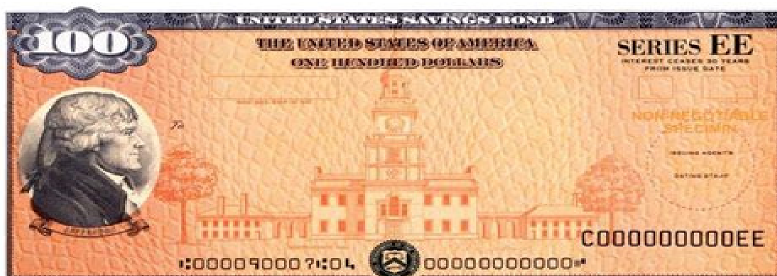
This past year the rate has been 7.12% and I began purchasing a bond each week and have set a schedule to buy one each week for the next year.   You can buy amounts as low as $25 and buy up to $10,000 per household member per year (more if you buy paper I-Bonds with income tax refunds).   Verify these facts at TreasuryDirect.gov.

In a time of turbulent stock market fluctuations, this is a rock solid investment in my estimation.   Consult a Financial Planner or your accountant before making any investment decisions.

IN CONCLUSION

So to summarize, bonds are considered safer investments than most.   You can buy Mutual Funds that are all bonds or you can get a mix of bonds and stocks in various funds.   Also there are ETFs for just the bond market.   Be sure you understand that these funds and ETFs can lose value or gain value as interest rates go up and down.   It is not a lock, whereas if you purchase the bond yourself, it has a guaranteed principal and fixed rate of interest. (most of the time.)

We will expand on this topic again in a future article and go into deeper detail. Should you include bonds in your portfolio?   I believe the answer is always yes, even if just a small percentage.



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