A Primer for Investing in Bonds

Bonds belong in your investment plan for a number of good reasons

For a variety of reasons, Americans are increasingly making bonds an important part of their investments. Bonds are basically IOUs, but they’re more complex than this popular abbreviation suggests. One way to learn about investing in bonds is with the booklet A Primer for Investing in Bonds. Here’s a sample of information in the booklet:

A bond is basically a loan issued by a corporation or government entity. The issuer pays the bondholder a specified amount of interest for a specified time, usually several years, and then repays the bondholder the face amount of the bond.

Bonds may belong in your investment plan for a number of good reasons:

- Bonds can provide a predictable stream of relatively high income.
- Bonds offer an opportunity to spread your risk.
- Bonds can generate impressive profits.
- Bonds can provide valuable tax advantages.

Note that the word “safety” doesn’t appear on this list.

How Do Bonds Work, Anyway?

Bonds are IOUs issued by corporations (both domestic and foreign), state and city governments, and their agencies, the federal government and its agencies and foreign governments. They are issued for periods as short as a few months to as long as 30 years, occasionally even longer.

When you buy a bond, you become a creditor of the issuer—that means the issuer owes you the amount shown on the face of the bond, plus interest. (Bonds typically have a face value of $1,000 or $5,000, although some come in larger denominations.) You get a fixed amount of interest on a regular schedule—every six months, in most cases—until the bond matures after a specified number of years. At that time you are paid the bond’s face value. If the issuer goes broke, bondholders have first claim on the issuer’s assets, ahead of stockholders.

After bonds are issued, they can be freely bought and sold by individuals and institutional investors in what’s called the secondary market, which works something like a stock exchange.

Many different types of entities issue bonds. Among them:

- Corporations: They may issue secured bonds, which are backed by a lien on part of a corporation’s plant, equipment or other assets. Or they may issue unsecured bonds, which are backed only by the general ability of the corporation to pay its bills.
- Municipal bonds are issued by state or city governments, or their agencies. Interest paid on municipal bonds generally exempt from federal income taxes and usually income taxes of the issuing state as well. General obligation bonds are backed by the full taxing authority of the government that issues the bonds. Revenue bonds are backed only by the receipts from a specific source of revenue, such as a bridge or highway toll.
- U.S. Treasury debt obligations are backed by the full faith and credit of the federal government. Interest from Treasuries is exempt from state and local income taxes but not from federal income tax.
- Agency securities are issued by various U.S. government-sponsored organizations, such as the Tennessee Valley Authority. Although they are not technically backed by the full faith and credit of the U.S. Treasury, they are widely considered to be moral.
A Primer for Investing in Bonds

You’re better off using funds to buy risky bonds.

The following booklets from the Editors of Kiplinger’s Personal Finance magazine and the Investor Protection Trust are available at your library and offices of State Securities Regulators.

Five Keys to Investing Success
Make investing a habit
Set exciting goals
Don’t take unnecessary risks
Keep time on your side
Diversify

The Basics for Investing in Stocks
Different flavors of stocks
The importance of diversification
How to pick and purchase stocks
When to sell
Key measures of value and finding growth
What’s your return?
Consider mutual funds

A Primer for Investing in Bonds
How do bonds work, anyway?
How much does a bond really pay?
How to reduce the risks in bonds
Going the mutual fund route

Mutual Funds and ETFs: Maybe All You’ll Ever Need
Mutual funds: The best investment
The different types of funds
How to choose funds
Assembling a portfolio
Sources of mutual fund information
Where to buy funds

Maximize Your Retirement Investments
Three key rules
Creating the right investment mix
Investing on target
Best places to save
Guidelines for saving at every life stage
Getting the money out and creating an income stream
Protect your money: Check out a broker or adviser

Getting Help With Your Investments
Do you need a financial adviser?
Who’s who among financial advisers
How to choose an adviser
How to open an account
5 questions to ask before you hire an adviser
What can go wrong
How to complain

Where to Invest Your College Money
The basics of investing for college
Investing in a 529 savings plan
Locking in tuition with a prepaid plan
Other tax-favored ways to save
Tax credits for higher education
Save in your child’s name?

REBALANCE YOUR INVESTMENTS

Complete this worksheet at least once a year so you’ll know how your investment mix is changing. Then take action to bring it back into line with a mix that matches your goals and your risk tolerance.

HOW TO DIVERSIFY

Market Value
Percent of Total

CASH
Savings accounts
$__________
%__________

CDs
$__________
%__________

Money-market funds
$__________
%__________

Treasury bills
$__________
%__________

TOTA L CASH
$__________
%__________

STOCKS
Individual shares
$__________
%__________

Mutual funds
$__________
%__________

ETFs
$__________
%__________

TOTAL STOCKS
$__________
%__________

BONDS
Individual bonds
$__________
%__________

Mutual funds
$__________
%__________

ETFs
$__________
%__________

TOTAL BONDS
$__________
%__________

Rental real estate
$__________
%__________

Limited partnerships
$__________
%__________

Precious metals
$__________
%__________

Collectibles
$__________
%__________

Other investments
$__________
%__________

TOTAL INVESTMENTS
$__________
%__________

THE TRADITIONAL RISK PYRAMID

SPECULATIVE
AGGRESSIVE GROWTH
LONG-TERM GROWTH
GROWTH AND INCOME
CASH, CDs, SHORT-TERM U.S. DEBT

The higher up the pyramid, the higher your potential reward and the greater your risk of loss—and the smaller the proportion of your investments.