



[Click here for more investing tips!](#)

## **Smart Bond Investing: A Guide For Safely Increasing Returns With Bonds**

**Dan Eggertsen:** Hi everyone. I'd like to welcome everyone to the call. This is Dan Eggertsen. I'm here with my father Karl Eggertsen. How you doing, Dad?

**Karl Eggertsen:** Doing good Dan.

**Dan Eggertsen:** Good. So we've got three questions tonight to ask about bond investing and if you're ready I'd like to kick it off.

**Karl Eggertsen:** I think I'm ready. I think I'm ready to go.

**Dan Eggertsen:** Okay. The first question we're seeing a lot of is, "I have heard that in a tough economy bonds are better. Why is this true and should I put most of my money in bonds?"

**Karl Eggertsen:** Yeah. That is really a good question in the economy that we've been in and I'll do my best to try to answer it. Yes to a point it's important to have bonds. Particularly in markets like this that we've been through. It reduces losses. Bonds are not near as volatile as stocks. They hold their value better. To give you a few examples, the worst three months, historically over quite a number of years, the worst three months for stocks, when you're reporting losses was a minus 31% in three months. That's a huge loss. Bonds? 3% in three months.

**Dan Eggertsen:** 3%?

**Karl Eggertsen:** Okay? Now what I'm comparing is I'm comparing the US total international stock - the total US market. I'm looking at the Lehman Brothers aggregate index of bonds, the US total bond market in the US. I'm comparing those two. So I'm comparing total stocks to total bonds in the US and these are indexes; 31% for stocks, negative and a negative 3% for bonds. A second example is in 1926. Okay, right? The Depression time. 18 to 20 years later, starting in 1926, bonds outperformed stocks by quite a bit. Of course you can't predict those kinds of periods but it goes to show that bonds can outstrip stocks performance-wise, depending on the economic climate. They stabilize their portfolio, they reduce risk and volatility, and they're kind of like a form of insurance.

Another important thing related to bonds is the value performs inversely to the interest rate. So if the value of bonds drop, the interest rates goes up so you're getting more income. If the bond values are going up in value, the interest rates drop so they're inversely proportional. That's a unique thing about bonds. No matter what's going on, you're making money. You're always getting some interest but you could be getting a lot more interest in certain economic environments than others.

**Dan Eggertsen:** So it sounds like you can't go wrong with bonds. Is that what I'm getting?

**Karl Eggertsen:** Well you're always going to get some kind of return from them. Okay?

[03:31.6]

**Dan Eggertsen:** Right.

**Karl Eggertsen:** Unlike stocks. You can't be assured that in a bear market stocks are going to go down in value, a vast majority of them are. Dividends aren't guaranteed. Companies in bad times will stop their dividends many of them, or reduce them. So a bond is an interest bearing vehicle whereas a stock, you're more depending on equity growth.

**Dan Eggertsen:** Okay.

**Karl Eggertsen:** Okay? So it's a good thing to have bonds in your portfolio for most people at all times and it depends on what your needs are and so on.

**Dan Eggertsen:** Right.

**Karl Eggertsen:** Okay.

**Dan Eggertsen:** Okay great. Let's move on to the second question that we're getting.

**Karl Eggertsen:** Well okay.

**Dan Eggertsen:** Oh are you done with that first one or you have more to say?

**Karl Eggertsen:** Yeah. The other question on bonds is, "Should I put most of my money in bonds?"

**Dan Eggertsen:** Oh yes.

**Karl Eggertsen:** And I say, "No," for most people. Unless you have an awful lot of money and you're not going to run out of money because you're not going to be keeping up with inflation necessarily with bonds. It's best for most people to have a diversified balance of bonds and

stocks. It's a protective mechanism. Again looking back at total US stocks, if somebody had all their money in stocks, they would have lost 31% in the worst three months of whenever that worst three months was. If you had a diversified portfolio of 50% bonds and 50% stocks during that time, that worst three months you would have lost only 15%; so about half. You would have reduced your volatility by 50% if you'd had a portfolio that was split between stocks and bonds, okay?

So it goes to show you the value of balanced diversification and bonds and stocks. It ensures continuous growth in value of your portfolio. Two-thirds of the time stocks are going up historically. So you're always positioned for growth when you have stocks in your portfolio. You're always going to be getting income from your bonds. They are a stabilizing influence on your portfolio anyway and they can outperform stocks as we showed back in the Depression years and following that. Bonds way outperformed stocks 18 to 20 years and there've been other periods where bonds outperformed stocks. So it's a good bet to have both of them.

**[06:06.4]**

No one can predict what's going to happen anyway tomorrow and in the future so it pays to spread your bets around and have a diversified portfolio. Most important thing is to focus on your personal goals and your needs and your time horizon and your risk tolerance more than watching the market all the time. You want to position your portfolio for your personal needs and not watching the market, worrying about the market all the time.

**Dan Eggertsen:** Right. Okay. Gotcha. Is it true that - I've always heard that the older you get the higher percentage in bonds you want and less percentage in stocks? Is there any truth to that?

**Karl Eggertsen:** In general, that's true.

**Dan Eggertsen:** Okay.

**Karl Eggertsen:** Yeah.

**Dan Eggertsen:** I just wanted to clear the air on that one, make sure I had that right.

**Karl Eggertsen:** Right.

**Dan Eggertsen:** All right. Now let's move on to question number two. That was kind of a two-parter that first one. Sorry I forgot that.

**Karl Eggertsen:** No that's okay. I forgot too.

**Dan Eggertsen:** Okay. What exactly are bonds and how should I invest in them.

**Karl Eggertsen:** What are bonds exactly? They're an IOU. You lend money to a borrower. The borrower could be the government, a government agency, it could be a municipality in a city

or state, it could be a corporation. Okay? But you lend money to the agency or to the organization, the company, whatever and you receive a security, a bond paper or security and that security contains a principle par value and that's how much you lend.

Say you lend \$10,000 on a bond. So that's the par value of the bond and then there's an interest coupon that you get in return. Every month you will be getting – every month or every quarter, whatever period of time you get the interest, you are paid interest over a period of time for that money that you've lent to the government agency or company or corporation and there's a maturity date on it also.

There's a par value coupon and a maturity date. The maturity date is how many years that bond is in effect. At the end of that period, you have accrued all that interest over time and then you get your par value back when the maturity date is reached. So you get all your money back plus you've had interest on it. So that's basically what a bond is.

[08:39:1]

**Dan Eggertsen:** Okay. Great. Then what's the easiest way to invest in them? Just through a brokerage account or...?

**Karl Eggertsen:** Okay. I would recommend for the vast majority of people they go with bond funds. There are very inexpensive bond funds, very inexpensive and you get immediate diversification through a bond fund. You don't need a lot of dollars like you need many thousands, in some cases hundreds of thousands of dollars to get the diversification that you'd have with a bond fund by buying individual stocks. It would take an awful lot of money and most people don't have that kind of money, don't want to spend that kind of money and it's a headache managing a whole bunch of individual bonds.

Okay? The other advantage of a bond fund is you get interest monthly. You don't have to wait for a quarter or in some cases in six months. Individual bonds don't pay off the interest near as often as a bond fund does. A bond fund is simple; it's easy. You can sell it at any time, parts of it or all of it. You have professional management and it's cheap. Through Vanguard for example it's like 0.2% or less, maybe a little bit more depending on whatever the bond fund is. But it's very inexpensive and you get immediate diversification. Okay? Then I guess the other part of the...

**Dan Eggertsen:** You got them both pretty much. Basically you answered the question, "What are bonds," and then, "How should you invest in them?"

**Karl Eggertsen:** I guess the other part of the question was, "What bonds do I invest in?"

**Dan Eggertsen:** Yeah. This would be the third question now moving on. What bonds do you invest in personally? Are there different types of bonds? If so, what are the different types and what are the pros and cons? So maybe we're kind of lumping both questions together but let's just attack it in pieces here.

**Karl Eggertsen:** Okay.

**Dan Eggertsen:** What bonds do you invest in personally?

**Karl Eggertsen:** Personally I invest in a total bond fund. It's the equivalent of the Lehman Brothers aggregate bond index. It contains a variety of US bonds and it's very stable. I get one through Vanguard and it's one of the very top funds. It's very inexpensive. Its performance is just fantastic. It's very stable. It's very secure and it's held my portfolio together through the rough times that we've been in. I've got a large part of my bond portfolio in this fund.

**Dan Eggertsen:** Right.

[11:33.7]

**Karl Eggertsen:** I have municipal bonds in California. We live in California so I have a California municipal bond fund. But there're other states have municipal bond funds. So you could have them through the state or you can get a federal, you know one that's multiple states bond fund that encompasses bonds across the country and it's very diversified of course. It's federal tax free. The state municipal bond funds are federal and state tax free.

**Dan Eggertsen:** Right.

**Karl Eggertsen:** They're best for people who have an income bracket that's a little higher. Usually a 25% income tax bracket is usually the rule of thumb where you start making up by having a municipal bond fund over other kinds of funds. Okay. I have a high a yield bond fund. It provides higher interest but it's riskier. I also have a foreign bond fund. So I get some diversification internationally. So those are the four basic types of funds and I get most of them from Vanguard.

**Dan Eggertsen:** Okay. So you basically answered, hit this question too. "Are there different types of bonds and if so, what are the different types?" Now you mentioned four basic ones that you invest in. Can you kind of go into what the pros and cons are of each?

**Karl Eggertsen:** Yeah. Well in the total bond index fund, it contains mortgage backed securities or mortgage backed bonds. It contains government bonds through government agencies; treasuries. Corporate bonds are included in that index. The corporate bonds are a little bit more risky but provide a higher interest rate. The government bonds, like T-bills, treasuries are guaranteed and then you have agency bonds that are very safe. They're all part of the government bond area. The mortgage backed securities have typically been very safe but in the times that we're living in right now they're not near as risk free as they were because of the real estate market that we're dealing with.

**Dan Eggertsen:** Yeah. Okay.

**Karl Eggertsen:** So and then there's international developed country bond funds that are pretty safe. The difference there is you got currency and you also got political things that come up that could cause the international bond fund to become a little bit more risky but generally in today's world they're pretty safe as compared to the US. In the past, not so much so but as the global economy continues to come together, they're less and less risky. Or you can get higher interest rates in the international market as with the emerging developing countries like China and India and Brazil.

**Dan Eggertsen:** Oh is that right?

**Karl Eggertsen:** Yeah. You can get higher interest rates but also the risk is there too. You're getting into diversification here where you can get some of all of these and be better off.

[14:57.1]

**Dan Eggertsen:** That's the idea. You don't want to put all your eggs in one basket.

**Karl Eggertsen:** Right and the last thing I wanted to say about bonds in general is you've got duration is also a consideration in the bonds that you buy. Most all of these bonds that I've discussed here, they're short-term. You've got long-term. The short-term are safe for short-term money. Low risk. The return is not the greatest but it's greater than a money market fund these days; one to two year duration. Then you've got the long-term bonds that get into six, seven, eight years out to twenty years and they provide higher interest rate but there's more risk.

**Dan Eggertsen:** Right.

**Karl Eggertsen:** The intermediate-term bonds are the ones I kind of home in on because you get a good balance of both. You get a higher interest but you're not so far out in time that you have the higher risk that you have with the longer-term bond. The intermediate-term bond area might be best for many investors as an asset allocation tool.

**Dan Eggertsen:** Right.

**Karl Eggertsen:** So I think that covers the questions.

**Dan Eggertsen:** Fantastic Dad. I want to thank you so much for your time and I want to thank everyone for being on the call and we'll talk to you next time Dad.

**Karl Eggertsen:** Okay, Dan.

**Dan Eggertsen:** Thanks.

**Karl Eggertsen:** Okay.

[16:15.7]