FINANCIAL IN$IGHT

COMMITTED TO YOUR FINANCIAL INDEPENDENCE

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Investing In Bonds

In recent years bond portfolios have shown very impressive returns. No doubt this is steering many people into this area. However, we think that this unprecedented situation is over. This is not to say that holding bonds is a bad idea, just that you should not look for equity style returns from any of your fixed income investments.

Bonds can be a very important part of your fixed income portfolio. If selected properly they can provide an improved overall return with very little increase in risk. If not they can still provide an improvement in performance, but with a substantial increase in risk, an increase that we do not consider justified.

To develop a good bond portfolio, we recommend that you work directly with a competent stock broker, and avoid bond mutual funds. Fund managers can be under considerable pressure to show results, and with the recent history and nature of bonds, these expectations will be very hard to meet. This will cause many of them to try to trade their way to success or to take undue risks to up their performance. Either way, while they might succeed, they will not be running a portfolio that matches your objectives. So we recommend that you build your own bond portfolio.

Building a sound portfolio is not as hard as it sounds. First you find a good broker. Then you instruct them to find quality bonds, either government or top rated corporate bonds with one to five years to maturity. Then purchase a mix with the total amount divided between maturities of one, two, three, four and five years. This is called laddering. If your total portfolio is not that large, you may have to split between one, three and five year maturities, or something like two and four year maturities. However, the optimum split is between the five different terms.

Fund Managers Are Under Pressure To Perform

So their objectives may not match your own.

Once this is done, you only need to adjust the portfolio as bonds mature. Then you use the

proceeds to purchase new bonds with five years to maturity, which will keep the ladder complete.

The reason for using bonds of five years or less (short term bonds) is that they carry less market risk. There is also less chance of you missing out on any high interest periods because all your money is locked away. Of course the market risk is not important because you are not going to cash them in until they mature, ... RIGHT!

This strategy will provide you with a portfolio that is as safe or nearly as safe as holding Guaranteed Investment Certificates (GIC's), it should also provide a better return and more liquidity. In the long run, the returns will not match the returns of your equity holdings, but remember, this is part of the secure part of your portfolio.

When looking at bonds and other fixed income investments, remember the following. You loan your money to sound borrowers (governments and triple A companies) for a little return and a lot of security. To get a high return you must own the companies, and that is what your equity investments do.