

# Forbes

## HOW TO BUY BONDS



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Learning how to buy bonds is an essential part of your education as an investor. A well-diversified portfolio should always strike a balance between stocks and bonds, helping you ride out volatility while still capturing growth along the way.

### Why Invest in Bonds?

Bonds are a key component of every investment portfolio. They offer a reliable cash flow, predictable returns and less volatility than stocks.

“The purpose of fixed-income investments is to add diversification,” says Rich Powers, head of private equity at Vanguard. “If an investor holds a balanced portfolio of stocks and bonds, that helps them have a less volatile overall experience.”

Even when interest rates are low, fixed-income investments like high-yield debt or emerging market bonds can meet an investor’s need for income, although they carry additional risks.

### Where to Buy Bonds

There are multiple ways to own bonds, with different strategies tailored to the needs of every kind of investor. Some investors choose bond funds, while other investors own individual bonds.

### Individual Bonds

Individual bonds can be purchased either in primary markets, where the bond is purchased from the issuer, or secondary markets, where the bond is purchased from the previous holder.

Owning individual bonds lets you lock in a specific yield for a set period of time. This approach offers stability, as the yields offered by bond funds can fluctuate over time.

Individual bonds must be purchased whole, and most bonds are issued in increments of \$1,000. That means you need to fund your brokerage account balance with at least that amount to get started.

Buying individual bonds offers unique challenges. In addition to a wide range of moving parts inherent in each bond, the primary market can be difficult to access for all but the wealthiest investors. Meanwhile, the secondary market has less transparent pricing than primary issues.

### U.S. Treasury Bonds

Investors can buy Treasury bonds directly from the government at TreasuryDirect. Treasury bonds are available in 20- or 30-year terms and pay a set interest rate every six months.

“Treasury securities—including notes, bills, bonds, TIPS or FRNs—are available for noncompetitive bidding from TreasuryDirect for smaller retail investors without having to incur commissions and fees,” said Bryan M. Kuderna, a certified financial planner (CFP) and author of “What Should I Do With My Money? Economic Insights to Build Wealth Amid Chaos.”

When you buy bonds via TreasuryDirect, the prices and terms have already been set based on previous competitive auctions between large institutional buyers.

### Bond Funds

The easiest way to buy bonds is to invest in bond mutual funds or bond exchange-traded funds (ETFs). Funds own large, diversified fixed-income portfolios comprising hundreds or even thousands of bonds.

“This gives an investor exposure to a wide variety of fixed income securities, instead of investing in one specific holding,” says Jason Werner, a financial advisor and founder of Werner Financial.

Bond funds pursue a very wide variety of different investing strategies, and fund managers take care of buying and selling securities for the portfolio in exchange for annual fees.

“A bond fund can provide much greater diversification in maturity dates, credit quality and coupon rates with a relatively smaller sum of money,” says Kuderna. “Plus, there’s usually more efficient pricing available, since funds invest in much larger sums of money.”

### Online Brokerage Accounts

Online brokerage accounts make it simple to buy individual bonds or bond funds, subject to fees and commissions.

Purchasing shares of bond funds in your brokerage account is very straightforward—enter the ticker of the fund you’re interested in, plus the amount you want to buy.

Buying individual bonds via your brokerage account is more complicated. Typically online brokers offer access to bond secondary markets, which means that availability and prices wholly depend on existing holders looking to sell.

### How to Build a Bond Ladder

When it comes to buying individual bonds, one way to manage interest rate risk is to spread out the maturity dates for the bonds you hold. This is referred to as “bond laddering.”

Fixed-income investors use bond ladders to provide additional flexibility and adjust their holdings to changing market conditions.

For example, let’s say you have \$15,000 to invest in bonds. One option would be to spend it all on a single bond with a 10-year maturity date. In this case, though, your capital would be tied up for a decade, and plenty can change in the market in 10 years.

With a simple bond ladder, however, you would purchase three \$5,000 bonds with staggered maturity dates: One year, two years and three years, for instance. Then, as each bond matured, you would reinvest the principal in bonds with the longest term you chose at the outset—a 3-year maturity in this case. With this simple bond ladder, you would have \$5,000 to reinvest each year.

If interest rates are high, you gain the advantage of better yields. If they’re low, the ladder still includes maturities locked in at higher yields. Plus, you can stagger coupon payments to improve cash flow.

Jason is the founder of Werner Financial in Indianapolis, Indiana. He has over 10 years in the industry as a registered investment advisor and holds Series 6, 7, 62, 63, & 65 licenses. Werner Financial aims to be the advisor on your team that helps you achieve all the goals you have set for yourself, your business, and or your family.

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### How to Buy Bond Mutual Funds

Bond mutual funds own large, diversified portfolios of fixed-income securities. They make bond investing easy, although they also charge management fees.

“With a bond mutual fund, investors get the benefit of fixed income professionals managing the money, as well as being in a pooled fund where they’re holding hundreds of bonds and the likelihood of one bond disproportionately impacting your results is much lower,” says Powers.

### Who Should Consider Bond ETFs?

Bond ETFs are suitable for investors looking for bond-like returns, but who also want exposure to many holdings inside one fund.

“This adds a level of diversification to a portfolio, since a single ETF can be made up of many holdings,” says Werner. “The ETF setup provides a liquid feature to get in and out of a fund at the investor’s discretion, but still have the long-term investment set-up of fixed income.”

Keep in mind that bond ETFs still have fluctuations in price, but they’re designed in a manner to be less volatile than equity portfolios or stock ETFs.

### Bond ETF Advantages

The level of portfolio diversification that they add, as well as the liquidity to get in and out of a holding according to the individual investor’s plan—are big pros of bond ETFs.

### Bond ETF Disadvantages

One of the more notable cons of a bond ETF or bond fund would be the management fee/expense ratio associated with them.

“Different investors can have different opinions on what would be deemed a fair or high fee,” said Werner, “but either way, this is an expense that could potentially cut into profits or return of a portfolio over the duration of holding the fund.”

### The Bottom Line

Buying bonds—whether individual bonds, bond mutual funds or bond ETFs—provides diversification and reliable income for your investment portfolio, but keep in mind that not all bonds are created equal.

“While they can all fall under the umbrella of ‘fixed income,’ Treasuries are the safest, being backed by the full faith and credit of the U.S. government, versus high-yield or junk bonds being the riskiest,” says Kuderna.

With all bond-related investments, you must do your due diligence: Research issuers, compare bond ratings, and if possible, consult with your investment professional to help guide your choices.

Read the entire article here: <https://bit.ly/3K7vL8e>