



## Buying and Selling Bonds

### How to Invest

There are several ways to invest in bonds. You can buy individual bonds, bond funds or unit investment trusts.

### Individual Bonds

There is an enormous variety of individual bonds to choose from. Your investment advisor can help you find a bond that matches your investment needs and expectations. Most individual bonds are bought and sold in the over-the-counter (OTC) market, although some corporate bonds are also listed on the New York Stock Exchange. The OTC market comprises hundreds of securities firms and banks that trade bonds by phone or electronically. Some are dealers that keep an inventory of bonds and buy and sell these bonds for their own account; others act as agent and buy from or sell to other dealers in response to specific requests on behalf of customers.

If you're interested in purchasing a new bond issue, your investment advisor will provide you with the security's offering statement, or prospectus—the official document that explains the bond's terms and features, as well as risks that investors should know about before investing.

You can also buy and sell bonds which have already been issued. This is known as the secondary market. Many dealers keep inventories of a variety of outstanding (i.e., previously issued) bonds.

Bonds sold in the over-the-counter market are usually sold in \$5,000 denominations. In the secondary market for outstanding bonds, prices are quoted as if the bond were traded in \$100 increments. Thus, a bond quoted at 98 refers to a bond that is priced at \$98 per \$100 of face value, or at a 2% discount.

Bond prices normally *include* a markup, which constitutes the dealer's costs and profit. If a broker or dealer has to seek out a specific bond that is not in their inventory for a customer, a commission may be added to compensate for the costs and efforts of serving the customer's special needs. Each firm establishes its own prices within regulatory guidelines, which may vary depending upon the size of the transaction, the type of bond you are purchasing and the amount of service the firm provides.

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For U.S. Treasuries, corporates and other bonds, there are also a number of Internet sites, media sources and vendors that provide current information on new issues. The Association's investor Web site provides price information and links to multiple services providing price/yield information on all market segments. Additionally, you can compare prices for specific securities by getting bids from several dealers.

## **Bond Funds**

Bond funds offer investors another way to invest in the bond markets. Bond funds, like stock funds, offer professional selection and management of a portfolio of securities. They allow an investor to diversify risks across a broad range of issues and offer a number of other conveniences, such as the option of having interest payments either reinvested or distributed periodically.

Because a fund is actively managed, with bonds being added to and eliminated from the portfolio in response to market conditions and investor demand, bond funds do not have a specified maturity date. With "open—end" funds, you are able to buy or sell your share in the fund whenever you choose. But because the market value of bonds fluctuates, as previously described, a fund's net asset value will change from day to day, reflecting the cumulative value of the bonds in the portfolio. As a result, when you sell, the value of your investment—as reported in most daily newspapers—may be higher or lower, depending upon how the fund has performed since you purchased your share. "Closed—end" bond funds have a specific number of shares that are listed and traded on a stock exchange. Because the fund managers are less concerned about having to meet investor redemptions on any given day, their strategies can be more aggressive.

There are numerous sources of mutual fund information available, including major personal—finance magazines and the business pages of your daily newspapers. Well—known mutual fund research firms, such as Morningstar Inc. and Lipper Analytical Services, provide detailed analyses by subscription. Many libraries subscribe to these services. In addition, rating agencies also evaluate bond funds for credit and safety.



Most funds charge annual management fees averaging 1%, while some also impose initial sales charges (some up to 5%) or fees for selling shares. Because the annual management fees will lower returns, investors need to be aware of the total costs when calculating their overall expected returns. The minimum initial investment is usually between \$1,000 and \$2,500, and \$500 for retirement accounts.

## **Money Market Funds**

Money market funds, as the name implies, refer to pooled investments in short—term, highly liquid securities. These securities include U.S. Treasuries, municipal bonds, certificates of deposit issued by major commercial banks, and commercial paper issued by established corporations. Generally, these funds consist of securities and other instruments having maturities of three months or less. Money market funds also offer convenient liquidity, since most allow investors to withdraw their money at any time. However, money market funds are not insured or guaranteed by the U.S. government and there can be no assurance that the fund will be able to maintain a stable net asset value of \$1.00 per share. The minimum initial investment is usually between \$1,000 and \$10,000.

## **Bond Unit Investment Trusts**

Bond unit investment trusts offer a fixed portfolio of investments in government, municipal, mortgage—backed or corporate bonds, which are professionally selected and remain constant throughout the life of the trust. The benefit of a unit trust is that you know exactly how much you will earn while you're invested in it, because the composition of the portfolio remains stable. Also, since the unit trust is not an actively managed pool of assets, there is usually no management fee, but investors do pay a sales charge, plus a small annual fee to cover supervision, evaluation expenses and trustee fees. The minimum initial investment is usually between \$1,000 and \$5,000. As an investor, you can earn interest income during the life of the trust and recover your principal as securities within the trust are redeemed. The trust typically ends when the last investment matures.