

Bond Funds or Bonds for Retirement Planning?



A recent issue of *Barron's* advised "[Beware of Bond Funds.](#)" Should you?

If you are managing your own portfolio of investments, you may want to take a look at some different bond investments in today's market. Most portfolios have some allocation to bonds and for people who are closer to retirement or in retirement, they will typically have a higher allocation. The main reasons to increase your bond allocation as you approach retirement are that historically bonds have been less volatile and lower in risk than stocks and retirees like to live off the dividends that bonds pay out.

Let's come back to the July 10 issue of *Barron's* with its headline reading "Beware of Bond Funds." The author pointed out that as interest rates rise, the values of bonds decline. He went on to say if you are holding individual bonds, you can wait it out until the bond matures and then get your principal back. But if you are in a bond fund, the bonds don't mature and the value can drop.

So what do you do?

The author recommends buying individual corporate bonds for your portfolio. I disagree. Unless you have \$500,000 or more to invest (and know what you are doing), you will be paying high fees, sometimes up to 2 to 3 percent for the bonds, and those fees will negate the reason for buying bonds in the first place.

I recommend **two bond fund strategies:**

1. **First, put some of your money in a bond fund.** Make sure the bond manager has sufficient latitude to invest in a variety of bonds. Having the ability to sell bonds that are subject to interest-rate-risk and buy other more opportunistic bonds (such as high-quality mortgage-backed bonds that don't typically carry interest-rate-risk) gives the manager the leeway to protect your principal.

For example, the [Pimco Total Return Fund](#) had a positive performance of 15.43 percent from May 31, 2004 to August 31, 2007, when interest rates rose to 5.25 percent from 1 percent. This bond fund also returned 11.67 percent from May 31, 1999 to Dec. 31, 2000, when interest rates rose from 4.75 percent to 6.50 percent. If you read this bond fund's prospectus, the bond fund manager has a lot of freedom to move around in the bond market and that is why they performed so well when interest rates went up.

2. **Second, consider the Claymore Securities Fixed Income Exchange Traded Funds (ETFs) that actually mature at a specified date.** Claymore's ETF bond fund managers invest in a basket of bonds that mature at pre-determined year. These bond strategies give you a low-cost advantage (0.24 percent) of owning individual bonds, the benefit of a diversified portfolio of bonds that most investors cannot achieve on their own, and a definite maturity date to get your principal back. There are some risks of investing in these bond funds but I would definitely put them on the lower risk scale relative to many other bond strategies.

As always, be sure you understand what you are investing in.



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