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By Susan Carr-Templeton /

Short-term Investments in Bonds

In my last blog, I discussed the importance of diversifying your portfolio and investors' concerns about diversifying by investing in bonds. At this time, investing cash in bonds with interest rates so low is definitely risky, as when interest rates rise, the values of bond funds will most likely go down.

However, there are several ways to add yield to your short-term investments through investing in the bond market. Here are a few that you should consider. Even better, spread your risk among several of these choices.

• Invest directly in bonds instead of buying a mutual fund. Individual bonds should be bought in increments of $25,000 or more, and you need enough investment to buy 8 to 10 bonds for proper diversification. Their value may decline at times over the life of the bonds, but you will have peace of mind knowing that when they mature, you will receive the full par or face value, assuming the bond does not default. You should buy bonds through a reputable firm as the spreads (the difference between what you pay for the bond and what the seller receives for the bond) can be as high as 3 percent. You want to minimize the spread so that you pay as little for the bond as possible, thereby maximizing your yield and return. If you ladder the bonds' maturities, then, as each one comes due, you can use the proceeds to invest in new bonds at potentially better rates.

• Consider a bond fund (instead of individual bonds) whose manager can invest in a variety of fixed-income securities, which are less interest-rate sensitive. Those investment types can include TIPS (Treasury Inflation-protected Securities), floating-rate bonds, high-yield bonds (typically trade in line with stocks), mortgage-backed securities (generally go up in value as interest rates increase, because people typically do not refinance at higher rates) and emerging market bonds (typically less sensitive to changes in U.S. bonds). A couple of funds to consider are TGBAX (Franklin Templeton Global Bond Fund), Pimco Unconstrained Bond Fund (PFIUX) or the tax-managed version, which is PUTIX.

• You can also invest in the above securities directly or through a security-specific fund, if you prefer. In my opinion, however, these comprehensive *unconstrained* funds offer diversification and low transaction costs. In addition, their objectives include adjusting portfolio holdings to take advantage of opportunities and to protect assets from interest-rate and credit risks.

• Consider including a short-duration bond fund. My favorite is ITM, Market Vectors Intermediate Municipal Index exchange-traded fund (ETF). Note, the shorter the duration, the less interest-rate sensitive the bond fund.

Whatever you decide, recognize there remains a risk of principal loss, and past performance does not guarantee future results.

Disclaimer: The views expressed in this article are the opinions of the author and should not be interpreted as individualized investment advice. Investment objectives, risk tolerances and the financial situation of individual investors may vary. Please consult your financial and tax advisors before investing.

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Susan Carr-Templeton is an Oak Brook-based financial planner and wealth manager with more than 20 years of investing experience. With a fee-based model, she also works with clients in DuPage and Hinsdale, Illinois. In addition to managing Stafford Wells Advisors, Ms. Carr-Templeton volunteers on the investment committee for the Advocate Foundation. She offers personal finance on investing, saving, retirement and more in “Making the Most of Your Money.”