

## ***Bond Basics***

**By Robert Shapiro**

Many personal financial advisors recommend that investors maintain a diversified investment portfolio consisting of bonds, stocks, and cash in varying percentages, depending upon individual circumstances and objectives. Bonds typically offer a predictable stream of payment and repayment of principal, many people invest in them to preserve and increase capital.

A bond is a debt instrument in which the issuer promises to pay to the bondholder principal and interest according to the terms and conditions of the bond. Simply a bond is a loan and you are the lender. The borrower usually is the U.S. government, a state, a local municipality or a corporate business. All of these entities need money to operate, so they borrow capital from the public by issuing bonds.

Interest is the money the issuer pays to the bondholders. Bonds pay interest that can be fixed, variable or payable at maturity. The stated interest rate of a bond is referred to as the coupon rate. The maturity date of a bond refers to the future date on which the investor's principal will be repaid. From the time a bond is purchased until maturity its price in the market place will fluctuate according to market conditions. Most bonds pay interest twice per year at a fixed rate. For example, a \$1000 bond with an interest rate of 6.0% will pay investory \$60 per year, in payments of \$30 every six months.

The current yield of a bond is the ratio of the interest to the market price of the bond. A more effective measurement is yield to maturity or call. This is the calculated return on investment that an investor will get if they hold the bond to maturity or call date. It takes into account the present value of all future cash flows, as well as any premium or discount to par that the investor pays.

There are a number of key variables to look at when investing in bonds: maturity, redemption features, credit quality, interest rate, price, yield, and tax status. As you build an investment portfolio of fixed income securities there are various techniques you and your investment advisor can use to help you match your investment goals with your risk tolerance.

*WBPA - The Warren Showcase - June 2003*