A Question of Muni's or Bond Funds

Date - 09/03/09 " I have read with great interest your thoughts on Bond Funds. For retirement funds are there any bond funds that you still like (i.e. perhaps muni's of short to intermediate term) or will rising interest rates take every indebted instrument down?" Mike

ANSWER: I think you will find that muni bond funds have gotten rich.

The issue with bond funds is interest rate volatility. If you are planning to hold the bond funds for a long time - 10 yrs - before you sell them for cash and living costs, then you can go for the highest yields. A bond fund that correlates with the Barclay's/Lehman Bros. bond index will give you the best yields. In retirement, yield is the important criteria.

When buying bond funds, expenses are important. You want to buy the least expensive fund that follows the Barclays index. Vanguard would be a good place to look.

That said if you will need the cash in retirement or for other reasons, bond funds are not a good place to be. Interest rates are pretty close to their lows right now. When the recession ends, you will see the 10 year treasury at its lows. Rates will go higher from there. That means that the price of bond funds will go down. You will lose money when you sell at the lower prices.

I prefer to buy the securities rather than own funds, for the fixed income we put into investor accounts. Current yields on these portfolios are about 6%+. The maturities are laddered out to 10 years with 10-15% cash flows on an annual basis from principal payments. The investments include government guaranteed mortgage backed securities (GNMA, FNMA, FHLMC bonds), high quality and survivor company corporate bonds, some whole loan mortgage backed securities, and some creative FDIC insured bonds (i.e. steepener bonds adjusting quarterly to a spread between the 10 yr and 30 yr treasuries).

For those in retirement, and who rely on stable, continuous cash flows, I like high quality fixed income securities that provide yields greater than 5%. It doesn't make sense to take less than 5% yields.

Do not buy the so-called "High Yield" bond funds for your fixed income portfolio. These junk bond funds trade like equities and are way too volatile for a retirement fixed income portfolio.

Today, preservation of capital is perhaps the most important criteria when investing. I am very attentive to risk management. A good yielding, high quality fixed income portfolio is a cornerstone of good investment management. For equities investing, stop-loss points are mandatory.

Does that help, Mike? If you need specific bond fund recommendations, I can come back to you with a couple.