

# WEST SIDE NEWS

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## Your Money, Your Business

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## Not All Fixed-Income Instruments Are Alike

*Make sure you know what you're buying*

Every well-balanced investment portfolio will include some fixed-income instruments. They are not generally considered a wealth-building tool, but rather a wealth preservation tool. Fixed-income investments can be the anchor that allows an investor to risk capital in equities while producing a predictable income stream. In general, the fixed-income portion of your portfolio is considered the conservative part. But as the last two years have shown us, even the conservative part of your investment portfolio can experience significant losses in a volatile market.

Fixed-income instruments are securities (usually bonds) that pay a fixed amount to the investor. Typically, bonds that pay higher rates of interest are those with a higher level of risk while those paying a lower rate (or coupon) are generally less risky. Buying a bond is equiva-

lent to loaning your money to the issuer (corporation, municipality, U.S. gov't) of that bond. The more risk there is that you will not receive your interest payments or get your principal returned at maturity the higher coupon you should expect to receive.

Bonds are rated from AAA to D, based on the likelihood that the bond issuer will be able pay the interest payment (coupon) in a timely manner and return the principal when the bond matures. In general, the better the rating, the lower the interest (and the better chance of the bond paying off at maturity). Bonds rated BB or lower are considered being below investment grade and often referred to as "high yield" or "junk" bonds.

Although high yield bonds may from time-to-time be appropriate in some portfolios, generally you want your fixed income portfolio to be very boring. For

most investors, limiting most of their risk to their equity investments makes more sense as there is a greater likelihood of capital appreciation. One reason so many investors got caught up in the volatility of the last several months is that they assumed all fixed-income securities are a safe investment. They soon learned that not all fixed-income instruments are alike.

Some managers of fixed income portfolios including some bond fund managers invested in junk bonds and sold them as conservative fixed-income securities. Technically, junk bonds are a fixed-income security, but they have often proven to be anything but generators of fixed income in reality. When the viability of the issuers of junk bonds became more suspect, the bonds lost most, if not all, of their value making any interest they might be paying hardly relevant. In 2007 and 2008 many investors saw their fixed income portfolios decline as much as 90%, all the while they thought and sometimes were told that their assets were conservative. After all, they were invested in bonds right?

When you buy a bond, you're lending money to a company or governmental body. When the bond matures, you get your money back. Last year, due to liquidity issues in the market many investors began to dump their municipal and corporate bonds in favor of the safety of

government securities. This had the dual effect of driving up the price and reducing the yields on treasury bonds. The results were that values of junk bonds tumbled while intermediate and long-term treasury bonds increased as investors discovered that their tolerance for risk wasn't as strong as they had assumed. It is difficult to watch what is supposed to be the conservative part of your investment portfolio take double-digit losses and not do something.

Chasing the next big thing is a losing proposition. The way to be a successful investor is to work with a professional to make a plan and to stick with it. Know what you're investing in and learn about the risks associated with it. Your bond portfolio should allow you to rest well. Buy quality individual issues that will pay you your interest on time and will return your principal to you in full at maturity. Never buy a bond based solely on its current yield. Periodically review your portfolio with your advisor and make adjustments as circumstances change. Do this and you won't be caught up in a volatile market as other investors react to daily fluctuations.

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