

Investing In Bonds and Bond Mutual Funds Can Be A Good Deal.

Most people think of investing in Bonds as being a dry subject, and to a degree, they are right. However, boring can sometimes be a good thing, especially when it comes to investments. Too much "excitement" in your portfolio can lead to undue stress, so a diet rich in bonds and bond mutual funds can help smooth out the rough edges in a portfolio made up mostly of common stocks.

Bonds are generally considered to be less risky than stocks, but they are not without peril in their own right. The risk in a bond is directly related to the issuing company, and the type of debt instrument. Depending on the type of debt issued, and what underlying assets are involved, certain bond investments can be as risky or more risky than investing in stocks. But there's good news: with a higher risk generally comes a greater return.

Bonds tend to be less flexible to trade than common shares, so most individual investors will end up investing in a bond mutual fund. This has many advantages for the beginning investor, not the least of which is that she can rely on the investment experience of a firm that specializes in analyzing the companies, and their capability of repaying their notes.

The biggest risk associated with bonds is referred to as the interest rate risk. This term refers to changes in the market interest rates, which have a direct bearing on bond returns. Fixed-income securities, in general, move inversely with the changes in interest rates. What this means is that during a period of rising interest rates, like the current climate in the U.S. in 2006, people holding bonds will end up seeing declining bond returns. This will affect long-term issues the most.

In fact, the longer the time to maturity, the greater the risk of interest rate erosion becomes. For this reason, careful pruning of a bond portfolio becomes of greatest interest to the fund manager. One technique bond mutual funds use is staggering maturity dates so that they have less risk based on any one scenario. The great size of the funds allow them to do this easily and quickly.

The biggest risk for any bond holder is the risk that the company will default before making its' scheduled payments. This is directly related to how credit worthy the company is, and their capacity and will to repay their debts. Companies with lower credit ratings have to pay higher interest rates, just like consumers in the same boat. The worse the credit, the higher the interest rates to bond holders have to be in order to attract investment dollars. Companies with excellent credit ratings pay a much lower cost for capital, which is one of the reasons they have superior credit in the first place!

Whenever considering an investment in a bond, make sure first and foremost that the company has an excellent rating from Standard and Poors or Moody's. This will ensure they have the capacity to pay back your loan to them over the entire duration of the bond contract.

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About the Author

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