

[Invest in fixed income securities through bond mutual funds with low investment fees](#)

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Summary: Bond investing is a complex process that individual investors should leave to professional fund managers. By selecting among lower cost bond funds, investors can achieve higher returns. Bond funds also can provide a high degree of fixed income investment diversification very economically. Fixed income securities or bonds have different value characteristics than do common stock securities. Bonds require different valuation methods. Common stock investments give the investor a "claim" to part of the market value of the firm and to its dividends, if the Board of Directors declares any such payments. Compared to common shareholders, bonds give their holders a more senior claim to the firm's cash flow for bond interest and principal payments. If bondholders' claims cannot be met, then default and bankruptcy may occur. The firm could be forced to sell or liquidate or ownership could pass to its creditors and bondholders. Such events are usually difficult, slow, and distasteful processes. Figuring out whether bond obligations are likely to be fulfilled by issuers is best left to bond investment specialists. Securities pricing in the bond market is complex and different from the stock market. While a firm usually has only one kind of common stock, it could have dozens or even hundreds of different outstanding bond obligations. Setting current bond prices is complex. Few individual investors have the required skill, knowledge, information, and experience to make such assessments. For individual investors it is much more straightforward simply to hold bonds through a bond fund. Once a bond fund establishes its "style" for the type, maturity, and quality of bonds it will hold, it selects and purchases bonds with an eye toward maintaining that style. Maintaining targeted maturity is relatively straightforward. Determining investment quality is less straightforward, but bond mutual funds have analysts on staff and have access to the analytic services of bond ratings houses like Moody's,¹ Standard and Poor's,² and Fitch Ratings.³ Bond funds offer a much higher degree of diversification than most investors could achieve economically through the direct purchase of individual bonds. Bond funds offer a further advantage to individual investors, because a bond fund's professional traders should know how to trade efficiently in the bond markets. Bond market trading can be very expensive for individual investors, who usually cannot tell whether they are getting a fair market price. Sometimes, individual investors pay very high transaction expenses, when buying individual bonds. This is not an issue of bond market inefficiency. Rather, it is a problem of unfair treatment due to the obscurity of the bond pricing process and the willingness of certain traders to take advantage of individual investors. Bond portfolio management is a relatively specialized investment securities activity. You might expect that certain bond mutual fund managers would be more skilled than others and would produce higher bond returns. Better performance due to investment skill could, of course, justify paying extra fees. However, investment science has not detected a relationship between paying higher fees and obtaining better returns from the bond mutual fund industry. In fact, the opposite seems to be true. Higher expenses tend to mean lower net returns to individual investors. [See: "[Is it worth paying higher bond mutual fund management fees?](#)"] While different from the equity markets, the bond markets also tend to

be efficient from the standpoint of reflecting currently available information in prices. They are simply not easy to beat in the sense that it is difficult or impossible to detect and capitalize on mis-pricing. Once an individual investor has decided to purchase shares in a bond mutual fund, the selection process can be relatively straightforward. Bond mutual funds are just another financial product being marketed to fill an investment need. The fund companies that offer them make decisions on how they will compete – whether through advertising, agents, service, word-of-mouth, etc. Some chose to compete on price, i.e. lower fees, and others do not. To protect your interests – instead of the interests of the mutual fund companies – you need simply to determine the style of fund desired in terms of bond maturity and investment quality. Then, pick one or preferably several bond funds from among those with lower fees offered by reputable firms. If you pay higher fees, you will most likely just throw your money down a hole. If you are dealing with any agent or advisor who tries to promote a bond mutual fund with high fees and/or a bond mutual fund with a front-end load, just say no. Investment science indicates that there is no justification for paying higher expenses or a front-end load. Higher expenses tend just to lower your returns. A front-end load means that you are paying someone to sell you an investment. Paying extra to be sold to is hard to justify in any type of business transaction – whether in investments or in any other industry. It is easy to buy directly from bond funds and cut out the intermediary. Fixed income funds all have how-to-buy information on their websites and toll free customer service telephone numbers. In addition, note that there is one reasonable justification for a short-term, back-end redemption charge. If a fund has a longer average maturity and wishes to discourage shorter-term trading behavior, a redemption charge could be assessed for some limited period following a purchase to protect longer-term fund holders. A short-term redemption charge is not a back-end load. If a fund has such a redemption fee and you agree with why it is there, then you should confirm that all such fees collected are returned to the fund itself solely for the benefit of fund investors who stay in the fund for a longer period. In addition, of course, you need to make sure that it is highly unlikely that you will need to redeem your investment within this penalty window. See these related articles: ->“[Beware of large and hidden mutual fund costs](#)” ->"[Excessive investment costs are a huge problem for individual investors](#)" ->“[How much do hidden mutual fund trading expenses cost you?](#)” ->"[Passive individual investors are “free riders” who benefit from the higher costs of active traders](#)" ->“[The investment industry is not your investment partner](#)” ->“[What is the cost to investors of sub-optimal diversification?](#)" 1)

<http://www.moodys.com>

2) <http://www.standardandpoors.com>

3) <http://www.fitchratings.com>