

# Bond Case Briefs

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## Retirees, Minimize Your Costs When Buying Bonds.

***A new rule will require brokerage firms to disclose the markup or markdown on retail customers' trade confirmations for most corporate- and agency-bond trades.***

For investors buying individual bonds, it's time to play "the price is right." Regulators are implementing new rules designed to help small investors get better prices on their bond trades.

Unlike stocks, whose prices are easily tracked on an exchange, bonds generally trade in an over-the-counter market where many small investors simply accept the price that their broker pins on a bond. But that price typically includes a "markup" from the prevailing market price (if you're buying the bond) and a "markdown" if you're selling it. These ups and downs are largely profits for broker-dealers—and they're usually not disclosed.

The new rules will change that. Late last year, the Financial Industry Regulatory Authority finalized a rule requiring brokerage firms to disclose the markup or markdown on retail customers' trade confirmations for most corporate- and agency-bond trades. The Municipal Securities Rulemaking Board also announced a similar rule for municipal-bond trades.

"Hallelujah, it's about time" that markups were disclosed, says Marilyn Cohen, chief executive officer of Envision Capital Management, in El Segundo, Calif. Just as competition has driven down mutual-fund fees and brokerage commissions, "there should be a price war in markups too," she says, and the disclosure rules could make that happen.

Although the rules don't take effect until May of next year, they put a spotlight on the importance of trading costs for bond investors—and recent research shows just how high those costs can be. A 2015 study from the University of Southern California Marshall School of Business found that individual investors pay an average of 0.772% in transaction costs when trading corporate bonds—or \$115.80 on a \$15,000 bond trade. Meanwhile, investors buying a stock through an online broker might pay a commission of \$4.95 plus a penny or two per share in "bid-ask spread"—the difference between buying and selling prices.

Currently, many small investors don't even realize they're paying a markup, much less focus on its size. Investors buying the same bond on the same day and in the same amounts often pay very different prices.

But there are ways to minimize your bond trading costs. Online tools can help you research recent trades in the bond you're considering (or trades in bonds with similar characteristics) and raise your odds of paying a reasonable price. Armed with recent trade information, you may be able to haggle with your broker for a better deal. And when you have a better sense of how much bond trading is costing you, you can weigh the costs and benefits against alternatives such as bond mutual funds and exchange-traded funds.

To see recent trades, go to [www.finra.org/marketdata](http://www.finra.org/marketdata) for corporate bonds or [www.emma.msrb.org](http://www.emma.msrb.org) for municipal bonds, and enter the CUSIP numbers of bonds that interest you. By looking at trades

between dealers, you can get a sense of the prevailing market price. To figure out how much you should be paying, look for recent customer purchases of similar size to yours.

"If you're buying small, weeny positions [say 10 or 15 bonds at a time], you'll probably pay at least half a point," or a markup of 0.5%, for an investment-grade bond, Cohen says. If you're buying 50 to 100 bonds at a time, the markup may be closer to 0.25%, she says. Investors should expect to pay higher markups for lower-quality, "junk" bonds and bonds that are thinly traded.

But small investors can incur hefty trading costs even in higher-quality, less-obscure bonds. Research firm Municipal Market Analytics offers this example: Looking at a California general-obligation bond maturing in 2037, there were two inter-dealer trades on the morning of March 17 at nearly the same price: \$112.73 and \$112.67. Three minutes later, a customer bought \$50,000 worth of the bonds at \$115.10—2.2% more. Less than an hour after that, a large investor buying \$6.9 million worth of the bonds got something much closer to the inter-dealer price: \$112.99.

Such price discrepancies can make the muni market "very difficult for an individual investor," says Thomas Doe, president of Municipal Market Analytics. The market actually resembles a "flea market," he says, "because you have this eclectic product, very inconsistent supply and demand, and you're just trying to match the product with a buyer."

### **Prepare to Negotiate on Price**

As in a flea market, you may have to haggle to get a good deal. Investors "don't have to be price-takers," says Lynnette Kelly, the Municipal Securities Rulemaking Board's executive director. Prices can be negotiable. If you're offered a bond at a price well above recent trade levels, you can say, " 'Why would I pay that? No one has paid that today on this transaction,' " says John Bagley, MSRB's chief market structure officer. Then use comparable customer trades to name a price you think is fair.

In many cases, there may not be any recent trades in the specific bond that interests you. But recent trades in comparable bonds can give you a rough idea of how much you should pay for the bond you want. Use the advanced search on the Finra market data site or the price discovery tool on MSRB's EMMA site to find bonds with similar credit quality, maturity and other characteristics.

Muni-bond investors may be able to get the best price by buying newly issued bonds during the "retail order period," when orders are accepted only from small investors. That way, "on 10 or 15 bonds you'll get the same price as Pimco buying 14 million bonds," Cohen says.

Another simple way to limit your bond transaction costs: Trade them as little as possible. Hold individual bonds to maturity.

But some advisers question whether small investors buying individual bonds can ever get a fair shake. "I think it's a sucker's market," says Frank Armstrong, chief executive officer of Investor Solutions, an advisory firm in Miami.

When clients come to him with individual bonds, Armstrong says, he generally sells them off and replaces them with bond mutual funds or exchange-traded funds. Some bond funds charge annual fees of just 0.04%, while it can cost 4% or 5% to do a "round trip," meaning buying and selling reasonably liquid individual bonds, Armstrong says. "That just eats into your total return. In an environment where there's hardly any income in fixed income, why would you want to give that up?"

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