Bond Case Briefs

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What Record Low Bond Yields Mean for Investors.

The website Quartz reported recently that yields on U.S. 10-year Treasury bonds are lower than they have been since the days of Alexander Hamilton.

But when it comes to bond yields, zero is not the limit. Brexit and uneasiness about the global economy have pushed interest rates on a third of developed-country government debt into negative numbers as investors seek safe havens. That means countries like Germany, Switzerland and Japan are charging investors money for the privilege of holding onto their cash.

Government bonds are many Americans' introduction to investing, and for many of us they represent safety and solidity in a volatile world. In fact, lots of investors have been moving into bonds as the stock market has been in turmoil lately, which is part of the reason yields are falling.

But with returns so low, would we be better off putting money in the mattress?

Not surprisingly, investment managers say no. Bonds are still an important part of your diversification strategy for retirement. This is because they counterbalance movements in the stock market, and their yields are much more stable than those of stocks.

Here are some topics to discuss with your investment manager.

–What types of bonds are best for you?

Again, within the overall category of bonds, most people are most familiar with U.S. Treasuries. They have an interest rate or coupon that is set on the day you buy it and paid out every six months for a term that ranges from 1 to 10 years for Treasury notes, and up to 30 years for Treasury bonds. You get the full principal back when the bond reaches maturity, giving some insulation from market ups and downs. However, there is market risk if you need to sell before the term is up.

The same basic structure is in place for other types of bonds: those issued by foreign countries, by corporations, or by U.S. state and local governments or their agencies (known as municipal bonds). Note that muni bonds can have special federal tax exemption (and possibly state or local tax advantages if you buy them for the city and state where you live).

In all these cases, by buying a bond you are essentially lending money to the entity in question. In general you'll find higher yields where there is also higher risk of default, as when lending to developing countries or distressed U.S. cities, or when buying "junk bonds" issued by higher risk firms, particularly in the energy sector.

–Is it better to own bonds or bond funds?

Bond funds are basically collections of bonds with staggered maturities. Just as with mutual funds full of stocks, you pay a management fee and expense ratio. In fact, the increasingly popular target-date retirement funds tend to include both stocks and bonds.

And, because it's a bouillabaisse of different holdings, there is no guaranteed date that you'll get back your principal.

That said, many investment managers feel that it's difficult to properly diversify through buying individual bonds unless you have a lot of money to park specifically in fixed-income investments. (What "a lot" means can vary — some say half a million dollars, while others argue that a hundred thousand is plenty.)

And the pressure to diversify is increasing with yields on the standard Treasury bonds so low.

So to recap, for most beginning investors, proper exposure to bonds will come in the form of target-date funds which will give you a selection of U.S. Treasuries, corporate and foreign issues, alongside stocks.

For those with more assets or who are heading closer to retirement — meaning you are shifting more towards fixed-income investments — bond-only funds would be the next place to look.

If you are willing to be an active money manager or work with an investment adviser you trust, you should look beyond Treasuries to buy individual bonds across sectors.

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(Anya Kamenetz' most recent book is "The Test: Why Our Schools Are Obsessed with Standardized Testing, but You Don't Have to Be." She welcomes your questions at diyubook@gmail.com.)