


# Bond Ladders



*An Effective  
Strategy For  
Managing  
Fixed Income  
Investments*

- > Create a predictable income stream by staggering bond maturities
- > Help minimize interest rate and reinvestment risk
- > Preserve wealth and plan for the future
- > Generate incremental yield through appropriate credit exposure

***Bonds can play an important role in a diversified asset allocation strategy, particularly as an investor nears or enters retirement.*** If you are seeking to generate income from your investments, want to preserve your wealth, or planning for a future goal, then a bond ladder strategy may be appropriate for you to consider.

## What is a **Bond Ladder**?

A bond ladder is simply a portfolio of bonds or CDs which mature at regular intervals, generally over a period of several years. Money that comes due from maturing bonds is reinvested in bonds with longer maturities at the far end of the portfolio. This process

continues year after year as long as the investor's financial objectives remain the same.

The purpose of a bond ladder is to take the guesswork out of selecting and timing bond investments. It may be an ideal way to generate a consistent level of income for risk-

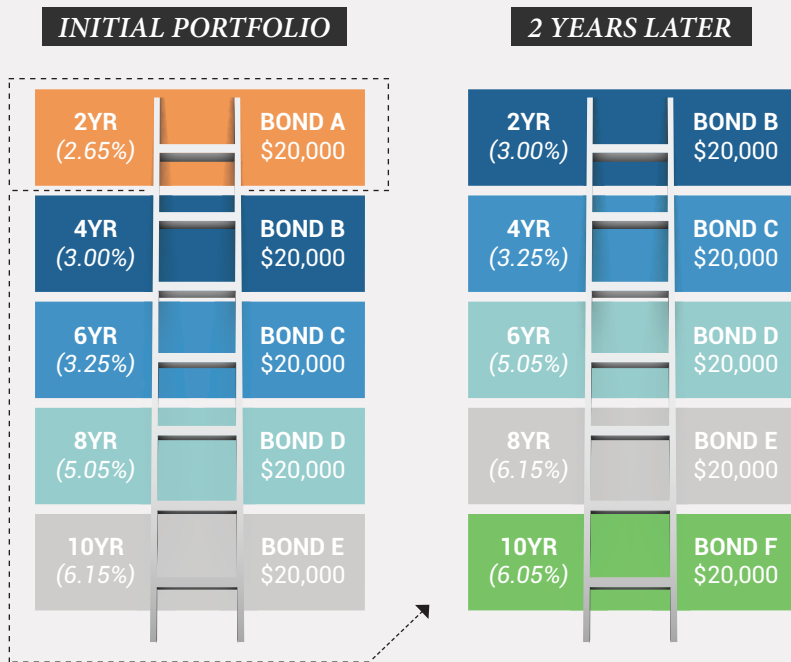
averse investors seeking first to preserve their accumulated wealth. A bond ladder strategy can also help investors balance their need for income today with the opportunity to benefit from higher rates later, should they rise.

## How it **Works**

Suppose you have \$100,000 to invest in bonds. Using a bond ladder approach, you could purchase five bonds, each with a face value

of \$20,000, which mature every two years. The figure on the next page shows this bond ladder with maturities of 2, 4, 6, 8, and 10 years

respectively along with their coupon percentage.



For illustrative purposes only. Does not represent the performance of any specific investment.

At the end of year 2, the shortest bond will mature, leaving you with \$20,000 in cash and four remaining bond investments now two years closer to their maturity date, with maturities of 2, 4, 6, and 8 years respectively. Proceeds from the maturing bond are reinvested back into the portfolio in a 10-year bond, making the portfolio now consist of 2, 4, 6, 8, and 10-year maturities.

This ladder strategy insures the investor always has a shorter-term portion which can be readily sold for cash if needed, and keeps the maturities staggered to help minimize interest rate risk.

## What are the *Benefits* of a Bond Ladder?

### Higher Average Yields

Generally, the longer a bond's maturity, the higher the yield. A bond ladder combines the higher yields of longer-term bonds with the liquidity of shorter-term bonds. Staggering bond maturities allow investors to earn potentially higher yields than would be possible with short-term investments alone and money market accounts. Likewise, a laddered strategy can help minimize market risks associated with only investing in single-issue, longer-term maturity bonds by allowing investors

to effectively manage duration risk (the price sensitivity of a bond portfolio to a change in interest rates).

### Predictable Cash Flows

A bond ladder can be constructed to provide periodic interest payments which can help investors match cash flows with cash expenditure needs. This can be especially beneficial for investors at or nearing retirement. Depending on the bonds in your portfolio, income payments can be scheduled to accommodate specific income needs.

For example, suppose an investor anticipates recurring yearly expenses at certain times, specifically in April (tax season) and December (holiday spending). A bond ladder can be structured to provide income payments during these time periods to assist with expenditures, as shown in the table below. Investors can benefit from higher rates on longer-term bonds to boost income and can reinvest principal maturing on shorter-term bonds if rates rise.

### MONTHLY INCOME BOND LADDER

				Interest paid each time period					
	Maturity	Par Amount	Yield	JAN/JUL	FEB/AUG	MAR/SEP	APR/OCT	MAY/NOV	JUN/DEC
<b>Bond A</b>	2Yr	\$25,000	2.60%	<b>\$325</b>					
<b>Bond B</b>	6Yr	\$25,000	3.40%			<b>\$425</b>			
<b>Bond C</b>	8Yr	\$100,000	5.05%				<b>\$2,525</b>		
<b>Bond D</b>	10Yr	\$100,000	6.15%						<b>\$3,075</b>

The hypothetical table above is for illustrative purposes only. Does not represent the performance of any specific investment.

### Manage Interest Rate Risk

By having bonds come due over nearly equal periods of time, you can help smooth out the effects interest rates have on portfolio valuations. How sensitive a portfolio's valuation is to a change in interest rates is known as a portfolio's duration. A bond ladder can be tailored to target a duration which best fits the investor's objectives and risk tolerance. Portfolio managers generally seek to reduce a portfolio's duration to combat the effects rising interest rates can have on a bond portfolio and seek to increase duration to monetize volatility in a declining interest rate environment.

### Mitigate Reinvestment Risk

Reinvestment risk is the risk that when a bond matures, the investor may not be able to reinvest their proceeds in a comparable bond at the same rate. By committing to a bond ladder strategy, investors can lessen the impact reinvestment risk can have on their portfolio. If interest rates rise, your maturing bonds take advantage of improved rates. If interest rates fall, your bond ladder portfolio holdings will most likely produce more income than could be achieved at the current levels, resulting in a more consistent yield.

### Maintain a Degree of Flexibility

With a bond ladder, you'll have one

or more bonds maturing on a regular basis. You can choose to reinvest your principal in another bond or redirect the proceeds for another purpose based on income needs and current investment objectives.

### Diversification

A bond ladder strategy also allows for a constructive level of diversification. In addition to diversifying your principal in bonds with different maturities, you can also build your bond ladder with different issuers and credit ratings. By diversifying a portfolio's weighted average credit quality, investors can potentially improve overall yield without incurring unacceptable levels of risk.

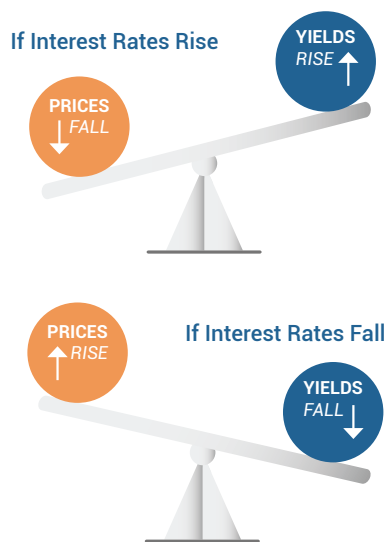
## What are the *Risks*?

Every investment involves a risk/reward trade-off. As a general rule-of-thumb, the more risk you are willing to take, the higher your return potential, and vice versa. While risk will vary based on the individual bond type, there are two main risks to consider when investing in any type of bond: market risk and credit risk.

**Market risk** is the risk that a bond may be worth more or less than what the investor paid, at any point in time, due to changes in interest rates. As previously discussed, bond prices have an inverse relationship with interest rates. Generally, if interest rates are rising, bond investors tend to hold shorter-term bonds because the longer a bond's time to maturity, the greater its price sensitivity. Conversely, if interest rates are

declining, bond investors will typically want to purchase longer-term securities to lock-in a higher yield which may not be available in the future.

### INVERSE RELATIONSHIP BETWEEN BOND PRICES AND INTEREST RATES



It is extremely difficult to accurately determine when interest rates will rise and fall. Maintaining a diversified laddered bond portfolio of short, intermediate, and possibly long-term bonds, and holding them to maturity, may be a good tool to help minimize market risk.

**Credit risk** is the risk that the issuer of a bond will not make timely interest or principal payments. To combat credit risk, more conservative investors should focus on higher-quality bond issues, as well as CDs and government securities. When utilizing a bond ladder strategy, investors can generate incremental yield by focusing on the overall credit quality of their portfolio.

## Where to *Start*?

While a bond ladder concept is a relatively simple strategy, proper implementation can be challenging. There are a number of factors to consider when building a bond ladder, such as bond type, income needs, time horizon, current market conditions, and tax consequences,

among other things. It can also be difficult and time-consuming to build a properly diversified bond ladder on your own.

The place to start is with your financial advisor. Bond ladders are custom-made and require some thinking and discussion. Together

with your financial advisor, you can tailor a bond ladder which helps reduce risk and can benefit your specific income needs and investment objectives.

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**For additional information about bond ladders or to discuss your individual investment situation, please contact your financial professional.**

A bond ladder strategy may not be appropriate for all investors. This report is for informational purposes only, does not pertain to any security product or service, and is not an offer or solicitation of an offer to buy or sell any product or service. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her advisors.

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