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About Bonds

Corporations, governments and municipalities issue bonds to raise funds. In return they typically pay the bond owners a fixed interest rate. In this way, a bond is like a loan. As part of a diversified portfolio, bonds can help you manage market fluctuations and generate income.

What makes a bond price go up and down?

- Interest rates may be the most significant factor affecting a bond's value. When interest rates fall, the market price of existing bonds rise because their fixed-interest rates may be more attractive in the market than the rates for new issues. Similarly, when interest rates rise, the market price of existing bonds with lower, fixed-interest rates tend to fall.
- Inflation may erode the purchasing power of interest income. Generally, bonds with longer maturities are more sensitive to inflation than bonds with shorter maturities.
- Economic conditions may cause bond values—particularly corporate bonds—to fluctuate. An economic change that adversely affects a company's business may reduce the perceived ability of a company to make interest or principal payments.

How to invest in bonds

Bonds may be traded in the market just like stocks, and you will typically pay a broker a fee if you buy or sell a bond. There is, however, one exception; you may purchase U.S. Treasury securities directly through the Treasury Direct program of the Federal Reserve System, in which case you do not need a broker's services and incur no fee beyond the bond's purchase price.

Two other ways to purchase bonds that offer diversification are bond mutual funds and unit investment trusts (UIT).

Bond mutual funds sold through a brokerage firm may charge a sales fee, or "load." No-load funds may be purchased directly from the fund company. You may also purchase a variety of load or no-load funds through most online brokerage firms. Some funds are sold on discount brokerage sites without a transaction fee, while others are subject to trading fees.

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