Scarsdale Investment Group, Ltd.

All Bond Portfolios

Vol 2, number 1, 2010

Summary:

Our view is that if you have a bond ladder, rising interest rates are the upside case.

Compound interest may be the key to your financial future.

In the end, short term investments might not be as safe as you think.

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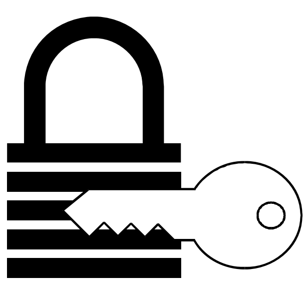
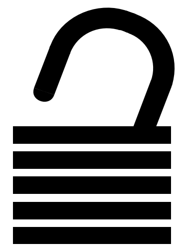
Investment Dilemma: Short-versus Longer-term Bonds

Many investors with whom we speak are concerned that inflation will rise significantly in the near term, and longer-term investments might lose value. If you share their concern, you might want to invest in short-term bonds, but are hesitant because the interest rates on short-term bonds are very low. However, you still might want to buy them because you equate short-term with safety and longer-term bonds with greater risk. If you do so, you will miss the opportunity for long-term compounding of interest, a key to your financial health. In the end, short-term investments might not be as safe as you think.



If you have a bond ladder, rising interest rates are the upside case because you will be able to reinvest your interest payments and the proceeds of bonds coming due at the then higher rates. For example, if over a period of years interest rates rise from 4% to 6%, your cash flow over time will rise 50%, reflecting your reinvestment at the higher rates. If you hold your bonds until they come due, you will have no loss of principal.

If you are just starting to purchase bonds, you may prefer to create a barbell rather than a ladder. The barbell includes some short-term bonds in anticipation of rising interest rates and some longer bonds to capitalize on their higher return. When you create a ladder or a barbell, compound interest, meaning interest earned on interest, can unlock the path to your financial future.



Choice: Short-Term vs Longer-Term Bonds

As of February 1, 2010 the tax-free money market funds returned from 0.01% to 0.03%, and bank certificates of deposits for one year ranged between 1% and 2%. One-year treasury bonds yielded 0.29%. Having your funds return little or no interest is very painful.

If the Fed decides to sharply raise short-term rates, as they did in 1994 and again in 2004, you may lose money. Investors lost 2% in at least one quarter of those years

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Summary:

If over a period of years interest rates rise from 4 percent to 6 percent, your cash flow over time will rise 50 percent, reflecting your reinvestment at the higher rates.

The supply of tax-exempt bonds, favored by those in the higher marginal tax brackets is declining.

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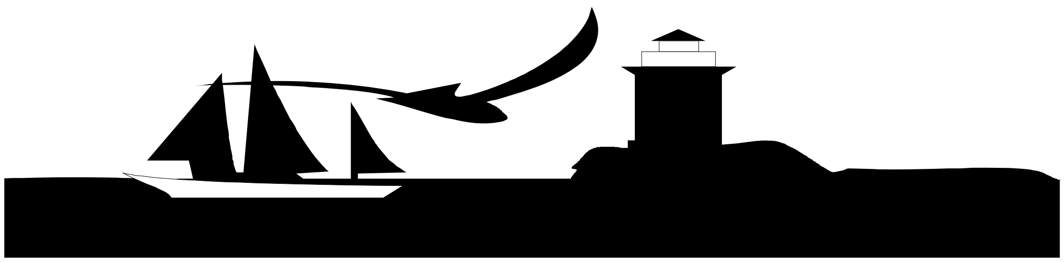
in short-term bond funds, according to MorningStar data.[1] You may have trading losses from trying to time the market as well.

If you purchase longer-term bonds, you could lock in 4% to 4.5% tax exempt returns (a 6.15% to 6.92% tax-free equivalent return for an investor in the 35% tax bracket.) If you could earn an average return of 4.5% percent on your bonds and reinvest the interest income at that rate, you can increase the value of your portfolio by 50% in 7.5 years.



National Factors Affecting Bond Investing Decisions

While many fear inflation, in the short term we are concerned about deflation. One popular view is that our economy will rebound and that the good times will return. The more negative view, as explained by Nouriel Robini, is that the debt burden and unemployment will continue to slow the economy.[2]

One thing that appears certain is an increase in our income taxes. That will make tax-exempt municipal bonds more desirable to an expanding number of investors as they are pushed into higher marginal tax brackets.

By January, 2010, the supply of tax-exempt bonds, favored by those in the higher marginal tax brackets, was eroding. Build America Bonds (BABs) are replacing tax-exempt munis mostly in the longer-term maturities. They are a new class of taxable municipal bond that many states and municipalities have chosen to issue in lieu of traditional tax-exempt bonds. This program may become permanent. According to Bloomberg, $71.5 billion of these BAB bonds have already been issued in a $2.8 trillion municipal debt market.[3]

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With long-term compounding of interest and the re-investment of principal, you will be able to plan for your future.

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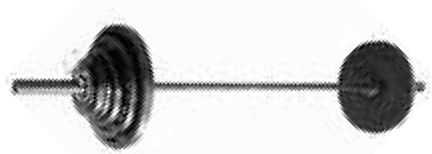
In summary, by choosing to purchase short-term bonds rather than longer-term bonds, you give up:

- Higher current cash flow
- Higher long-term yield
- Compounding your investment dollars at a higher rate of return

You also face the following possible market factors in a very complex world:

- Reduction in supply of tax exempt municipal bonds will dampen future yields
- Extended unemployment and slow growth that will continue to suppress interest rates
- Higher taxes

Of course, there are many factors to consider and the future is unknown.



We suggest that your best bet is to have a custom individual bond ladder, or barbell designed to your specifications, rather than trying to predict the direction of interest rates. With long term compounding of interest and reinvestment of your principal, you will be able to plan for your future.

Hildy Richelson, Ph.D. is President of the Scarsdale Investment Group, Ltd. and is co-author with Stan Richelson of BONDS: The Unbeaten Path to Secure Investment Growth, Bloomberg Press, 2007.

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Citations:

[1]Tom Lauricella, "Short-Term Bonds May Disappoint Investors This Year," The Wall Street Journal, February 1, 2010, p. R1.

[2]Simon Kennedy and Erik Schatzer, "Roubini Call U.S. Growth 'Dismal and Poor,' Predicts Slowing," Bloomberg.com, January 30th, 2010.

[3]Hans Nichols, "Obama Seeks Permanent, Expanded Build America Bond Program," Bloomberg.com, January 31, 2010.

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