Scarsdale Investment Group, Ltd.

The All Bond Newsletter

August 2009

Summary:

- Bond fund investments are not the same as owning individual bonds.
- Bond Funds behave like equities and trade like stock funds.
- Individual bonds pay a fixed rate of interest, then return the face value when due.
- Bond funds pay variable dividends.
- With individual bonds, you incur lower fees.
- Bonds come due; bond funds and ETFs do not.

Bond Funds = Individual Bonds — NOT

It's easier to buy bond funds. So, why buy individual bonds? This note will explain some of the advantages of individual bonds over bond funds.

Protection of Principal: At the outset, keep in mind that individual bonds will return their face value when they come due and will pay interest at fixed dates. Stocks may or may not pay dividends and never come due. This is the major distinction between stocks and bonds. Bond funds are like stocks in that they never come due. You cannot predict the future value of bond funds or their dividend payments. Thus, even bond funds that hold very secure bonds may not protect your principal.

Impact of Inflation: Inflation erodes the value of all investments. However, if you own a bond ladder of individual bonds, rising interest rates resulting from inflation will enable you to <u>increase</u> your cash flow and rate of return. This will occur if you reinvest your interest coupons and principal payments when your bonds come due in higher yielding bonds. You will have no loss on your individual bonds if you hold them until they come due no matter what their price is while they are outstanding. On the other hand, rising interest rates will <u>decrease</u> the value of your bond funds, possibly substantially, even if the funds hold very safe bonds. If your bond funds declines in value, it is unclear when you might recoup your losses.

Stan & Hildy Richelson, bond experts and authors of 4 bond books

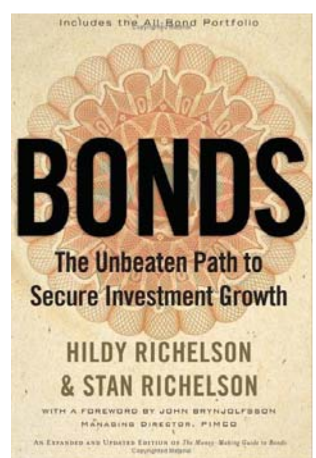
Costs: When you purchase an individual bond you pay a "spread", the difference between your purchase price and what the broker paid for the bond that is sold to you. This is a one-time cost to you. When you purchase a bond fund or bond ETF there are a variety of annual and one-time costs and transaction fees. If you buy an individual bond as a new issue, there is no spread.

Are you riding the bond fund rollercoaster?

Daily you will hear about the movements of Treasury bond interest rates. Bond prices and yields move in an inverse relationship. That means that when interest rates decline, bond prices rise. When interest rates rise, bond prices decline. It is a seesaw of ever fluctuating values. Should this matter to you?

If you purchase a bond fund or ETF the value of the fund will change automatically along with the fluctuation of interest rates. Thus, when you decide to withdraw cash from your fund, the price of your fund is at the mercy of the marketplace.

While an individual bond's value will also fluctuate, each day it marches one day closer to its due date. Unlike a bond fund or an ETF, you know that one day it will be redeemed at the bond's face value. This enables the individual bond holder to ignore market fluctuations, knowing that interest will be paid every 6 months, and the principal when due.



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