Focus on Fixed Income
1. Where am I today?
2. Where would I like to be?
3. Can I get there?
4. How do I get there?
5. How can I stay on track?

My Financial Needs
Our Objectives

• Increase your comfort level with fixed-income investments

• Explain how bonds can help you meet your investment goals
Three Things You Can Do with Your Money

1. SPEND
2. GIFT
3. INVEST
# Loan vs. Own:
## Two Ways to Invest

<table>
<thead>
<tr>
<th>Loan</th>
<th>Own</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds</td>
<td>Stocks</td>
</tr>
<tr>
<td>CDs</td>
<td>Stock mutual funds</td>
</tr>
<tr>
<td>Savings</td>
<td>Real estate</td>
</tr>
<tr>
<td>Bond unit trusts</td>
<td>Stock ETFs</td>
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<tr>
<td>Bond mutual funds</td>
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<td>Bond ETFs</td>
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</table>
Earning Money with Bonds

- Lend your money to a company, municipality, etc.
- Receive original investment at a set maturity date
- During the life of the bond, you receive interest payments
## Bond Characteristics

<table>
<thead>
<tr>
<th>Issuer</th>
<th>Maturity date</th>
<th>Call feature</th>
<th>Interest rate</th>
<th>Price</th>
<th>Rating</th>
<th>Taxation</th>
</tr>
</thead>
</table>

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Issuer

- Government entity, municipality or corporation
- Responsible for repayment of principal and making interest payments
Bond Maturities

- **Short term** (up to 5 years)
- **Intermediate term** (6 to 15 years)
- **Long term** (16 years or more)
Call Feature

• An issuer will often call a bond if it is paying a higher coupon than the current market interest rate.

• Similar to refinancing a mortgage, the company is usually seeking to pay a lower interest rate when it calls a bond.
Callable Bond Considerations

- May cause you to lose regular interest payment
- May put you in a situation where you must reinvest when interest rates are lower
Interest Payments

• If a bond pays a coupon of 5% and its principal value is $10,000, then it will pay $500 in interest a year

• If interest is paid semiannually, you will receive $250 twice a year
Typically, the more interest rates decline, the more existing bond prices rise. Longer-term bond prices rise more than shorter-term bond prices.

Typically, the more interest rates rise, the more existing bond prices decline. Longer-term bond prices decline more than shorter-term bond prices.

Source: Edward Jones. Based on a hypothetical 6% bond with an initial 30-year maturity that is noncallable. Example assumes an investment-grade bond with no change to the credit quality of the bond. Past performance does not guarantee future results. Diversification does not guarantee a profit or protect against loss. The value and price of a bond can fall as well as rise, so you may get back less than you invested if you sell prior to maturity.
How Interest Rates Impact Face Value

• A bond at a **premium** is selling for more than par

• A price of 105 means the bond is selling for 105% of par value – $10,500 = $10,500
How Interest Rates Impact Face Value

• A bond at a **discount** is selling for less than par

• A price of 95 means the bond is selling for 95% of par value –
  \[
  0.95 \times $10,000 = $9,500
  \]
# Bond Quality/Ratings

<table>
<thead>
<tr>
<th>Higher Quality</th>
<th>Investment Grade</th>
<th>S&amp;P</th>
<th>Moody’s</th>
<th>Fitch</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>AAA</td>
<td>Aaa</td>
<td>AAA</td>
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<tr>
<td></td>
<td></td>
<td>AA</td>
<td>Aa</td>
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<td>A</td>
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<td>A</td>
</tr>
<tr>
<td></td>
<td></td>
<td>BBB</td>
<td>Baa</td>
<td>BBB</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Lower Quality</th>
<th>Below Investment Grade (High-yield or “Junk” Bonds)</th>
<th>S&amp;P</th>
<th>Moody’s</th>
<th>Fitch</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>BB</td>
<td>Ba</td>
<td>BB</td>
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<td>C</td>
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</tbody>
</table>
Average Cumulative Corporate Bond Default Rates 1981–2018

Source: Standard & Poor’s, Edward Jones. Past performance does not guarantee future results. Diversification does not guarantee a profit or protect against loss. Cumulative average default rates are calculated by taking the weighted average of annual default rates in each rating category and accumulating the results across all the years covered by the study. In this way, they take into account any change in an issuer’s credit rating over time.
Average Cumulative Municipal Bond Default Rates 1986–2018

Source: Standard & Poor’s, Edward Jones. Past performance does not guarantee future results. Diversification does not guarantee a profit or protect against loss. Cumulative average default rates are calculated by taking the weighted average of annual default rates in each rating category and accumulating the results across all the years covered by the study. In this way, they take into account any change in an issuer’s credit rating over time.
Taxation

• Tax-free municipal bonds can help provide a source of income that’s free from federal and possibly state and local taxes

• Some bonds may be subject to the alternative minimum tax (AMT)

• Interest on corporate and most other bonds is taxable
## Taxable-equivalent Yield

### How Tax-free Munis Work

The taxable-equivalent yield is the interest you would need to earn on a taxable bond to equal the yield a municipal bond provides.

<table>
<thead>
<tr>
<th>Marginal Tax Rate</th>
<th>10%</th>
<th>12%</th>
<th>22%</th>
<th>24%*</th>
<th>32%*</th>
<th>35%*</th>
<th>37%*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax-free Yield</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.00%</td>
<td>2.22%</td>
<td>2.27%</td>
<td>2.56%</td>
<td>2.77%</td>
<td>3.12%</td>
<td>3.27%</td>
<td>3.38%</td>
</tr>
<tr>
<td>3.00%</td>
<td>3.33%</td>
<td>3.41%</td>
<td>3.85%</td>
<td>4.16%</td>
<td>4.67%</td>
<td>4.90%</td>
<td>5.07%</td>
</tr>
<tr>
<td>4.00%</td>
<td>4.44%</td>
<td>4.55%</td>
<td>5.13%</td>
<td>5.54%</td>
<td>6.23%</td>
<td>6.54%</td>
<td>6.76%</td>
</tr>
<tr>
<td>5.00%</td>
<td>5.56%</td>
<td>5.68%</td>
<td>6.41%</td>
<td>6.93%</td>
<td>7.79%</td>
<td>8.17%</td>
<td>8.45%</td>
</tr>
</tbody>
</table>

Source: Edward Jones. This example does not represent currently available rates and does not illustrate the effect of state and local taxes or the alternative minimum tax (AMT).

*These yields include the 3.8% Affordable Care Investment Tax in addition to the Marginal Tax Rate where applicable.
Why Invest in Fixed Income?

Fixed-income investments can help provide a **reliable stream of income**
Diversification Benefits

- Owning a variety of investment types
- Helping reduce overall portfolio risk
- Helping preserve investment principal

Diversification does not guarantee a profit or protect against loss.
Investment Pyramid

- Aggressive
- Growth
- Growth & income
- Income
- Cash

Source: Edward Jones.
Edward Jones Investment Philosophy

**Stocks**
- Diversify
- Buy quality
- Long-term focus (buy and hold)

**Bonds**
- Diversify
- Buy quality
- Long-term focus (ladder maturities)
Why Asset Allocation?

More than 90% of an investment portfolio’s return is the result of overall asset allocation, not particular funds held.

- 91.5% Asset Allocation Policy
- 4.6% Security selection
- 1.8% Market timing
- 2.1% Other factors

Diversifying between Stocks and Bonds

Why Diversify?


Source: Ibbotson (S&P 500 Index), Barclays Capital (Government/Corporate Index). An index is unmanaged and is not meant to depict an actual investment. Past performance does not guarantee future results. Diversification does not guarantee a profit or protect against loss in a declining market.
Edward Jones Recommended Bond Ladder

**Short term** (up to 5 years): 30%–40%

**Intermediate term** (6 to 15 years): 40%–50%

**Long term** (16 years or more): 15%–25%
Bond Laddering

**Stability**
Helps create a steadier, more dependable income stream by selecting bonds with varying interest payment dates

**Flexibility**
Staggered maturity dates help you fight interest rate fluctuations

**Diversification**
Invest in bonds with a variety of maturity dates and coupons, as well as by investment type, such as U.S. Treasuries, municipal bonds, corporate bonds and CDs
Short-term Income Volatility

Six-month CD Rates (1964–2018)

Source: Federal Reserve and FDIC. Past performance does not guarantee future results.
Summary

• Loan vs. own
• Importance of fixed income
• Relationship between interest rates and bond values
• Risks vs. steady income
• Strategy/laddering
Questions & Answers
Thank You

PLEASE COMPLETE YOUR EVALUATION NOW