# Book Review

## Bonds: The Unbeaten Path to Secure Investment Growth

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Author: **Hildy Richelson and Stan Richelson**
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It is fair to say that when various investments are discussed, whether in the classroom or on the nightly news, stocks get far more attention than bonds. There are widely quoted benchmark indices (e.g., the Dow Jones Industrial Average) for daily stock market performance but less visible metrics for fixed-income securities. In addition, with bonds there are no spectacular "garage startup to Fortune 500" stories that attract investors' attention. *Bonds: The Unbeaten Path to Secure Investment Growth* is a great resource for financial practitioners to brush-up on this often overlooked asset class.

*Bonds* is much more than an informative tome about characteristics of various fixed-income securities. It takes a strong stand that challenges conventional wisdom about the preeminence of stocks in investor portfolios. The book advances the case for holding an all-bond portfolio or at least a substantial portion of portfolio assets invested in bonds. The co-authors, Hildy Richelson and Stan Richelson, are nationally known experts on bond investing with five books about bonds on their resume and a Pennsylvania financial planning practice that designs bond portfolios for high net-worth clients. They are frequent presenters at national conferences for financial advisors (e.g., NAPFA) where their recommendations and rationale for investing solely in bonds are often hotly debated.

The authors believe that bonds provide as good or better returns than stocks without substantial volatility. This message is carried consistently throughout the book. Bonds also help protect principal and help investors overcome their fear of investing. A major theme of *Bonds* is that high-quality bonds, laddered to mitigate adverse interest rate movements, are a better investment than stocks for individual investors. Bonds can also provide growth through compound interest if interest income is reinvested.

*Bonds* is 511 pages long and organized into five parts and 21 chapters. Part I presents the case for investing in bonds and Part II describes the history of bonds, bond terminology, and how bond yields are calculated. Part III provides detailed information on various types of bonds. Individual chapters discuss U.S. Treasury securities, U.S. savings bonds, U.S. agency debt, mortgage-backed securities, municipal bonds, corporate bonds, international bonds, and "bond look-alikes" (e.g., certificates of deposit, fixed annuities, and preferred stock). This section of the book is the longest and provides a very valuable "one-stop" mini-book about available fixed-income securities. Part IV describes how to buy bonds, characteristics and disadvantages of bond funds, and how to select a bond fund or exchange-traded fund (ETF). The authors do not recommend bond funds (due to annual management fees, loads, and lack of a maturity date) but discuss them nonetheless. Part V describes the authors' bond investment philosophy and strategies for buying bonds in various economic climates. *Bonds* can be read cover to cover or used as a desk reference. The second edition was updated to reflect the 2008 financial market crash and its aftermath. Chapters 3 and 20 contain case study examples of the use of bonds to meet investor objectives and should be of special interest to financial educators.

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The authors' strong support for bonds begins in the Preface with a comparison of stock and bond performance during the 2000 to 2009 decade. U.S. large company stocks averaged -0.95% compared to about 5% for a typical portfolio of high-quality individual tax-free bonds. It should be noted, however, that this is the second edition of *Bonds* and the authors' recommendations to invest solely in bonds long preceded the post-financial crisis bear market and Great Recession. Recent economic events support their case even more. The authors state, "The strategy of stocks for the long-run has been seriously called into question" (p. xxxi). In the Introduction, the authors explain the layout of the book and refer readers to their Web site for additional information (www.AllBondPortfolios.com).

In the first sentence of Part I, the authors state the book's objective: "The main purpose of this book is to debunk the many myths surrounding investing in stocks and bonds and to provide new thinking for you to consider when developing and carrying out your financial plan" (p. 1). To this end, they succeed admirably. After reading *Bonds,* readers exit with a more balanced view of both stock and bond market performance as well as a better understanding of the nuances of fixed-income securities. Various types of investments are discussed in detail, making the book a valuable professional tool. In Chapter 1, *Bonds: The Better Investment*, the authors compare stock and bond performance and question long-held assumptions about the two asset classes. They also make a case for bonds' superiority with respect to income taxes, transaction costs, and risk.

Chapter 2, *The All-Bond Portfolio,* begins with the authors acknowledging that their philosophy of "investing the bulk of your funds in high quality bonds is the key to your financial success" (p. 29) is controversial. They then describe advantages of an all-bond portfolio including "better returns than stocks when you take into consideration the risks, taxes, fees, transaction costs, and the general bad timing of individual investors" (p. 30). They then proceed to describe how to design a portfolio comprised of "plain-vanilla" bonds (e.g., Treasury bonds, TIPS, U.S. savings bonds, highly rated municipal and corporate bonds, and foreign bonds denominated in U.S. dollars). In Chapter 3, *Adopting the All-Bond Portfolio: A Case Study,* the story of a client's portfolio makeover is presented.

In Chapter 4, *The Evolution of a Bond*, the authors present a historical perspective on the use of bonds as an investment. They describe how bonds have been issued in the U. S. since colonial times (e.g., Massachusetts bonds in 1690). Other notable events that involved bonds include the Civil War, two World Wars, the late 1980s Drexel Burnham Lambert junk bond scandal, and the introduction of inflation-protected TIPS (federal debt securities). Chapter 5, *The Life of a Bond*, describes how bonds are created, issued, and priced. It also describes bond terminology such as "coupon rate," "interest rate risk," "premium," "call," and "current yield" and rating agencies that provide data about bond risks.

As noted above, Part III of *Bonds* could be a book by itself with in-depth treatment of various financial securities within its 9 chapters. In Chapter 6, *U.S. Treasury Securities*, the authors describe federal debt obligations in detail including types, advantages, risks, and tax implications. Acronyms like STRIPS and TIPS are clearly explained. In Chapter 7, *U.S. Savings Bonds*, a similar overview is provided. Readers learn the difference between series EE and I bonds, and features of each. In Chapter 8, *U.S. Agency Debt*, the focus is on debt-issuing government agencies including the Tennessee Valley Authority and Fannie Mae and Freddie Mac both before and after their 2008 government conservatorship.

Chapter 9, *U.S. Agency Mortgage-Backed Securities and Collateralized Mortgage Obligations*, focuses on agency-backed mortgage securities such as Ginnie Maes and their close relative, the Collateralized Mortgage Obligation (CMO). Advantages, risks, and tax implications of each investment are explained. Chapter 10, *Municipal Bonds*, explores the nuances of bonds issued by state and local governments. Topics discussed in this chapter include tax advantages, default risk, and municipal bond insurance. In Chapter 11, *Municipal Bond Types*, the authors drill down deeper into municipal bonds and discuss taxable versus tax-free bonds (i.e., the tax equivalent yield formula), private activity bonds, the difference between general obligation bonds and revenue bonds, and more. Chapter 12, *U.S. Corporate Bonds,* discusses the $2.2 trillion corporate bond market. Topics covered include bond ratings, types of corporate bonds, advantages, risks, pricing information, and corporate high yield junk bonds. Chapter 13, *International Bond Markets*, describes types of international bonds (i.e., those not issued in the U.S.) and their advantages, risks, pricing, and special features.

The last chapter in Part III is Chapter 14, *Bond Look-Alikes*. These are securities that "look like bonds, and they often act like bonds, but they are not bonds" (p. 273). Among the securities discussed in this chapter are bank certificates of deposit (CDs), broker-sold CDs, single-premium immediate fixed annuities, deferred fixed annuities, nonconvertible fixed rate preferred stock, and dividend-paying common stock. As with all the previous chapters, advantages, risks, and tax implications are explained.

The focus on Part IV is teaching readers nitty-gritty processes of how to invest in various types of bonds. In Chapter 15, *How to Buy Individual Bonds,* the authors discuss the process of buying government bonds online through Treasury Direct, how bonds are priced, how to choose a brokerage firm, managed accounts, and key questions to ask at the point of purchase such as, "Is this bond subject to any calls?," "What is the coupon amount?," and "What is the bond's rating?" Chapter 16, *Bond Funds: The Good, The Bad, and The Worst*, provides detailed descriptions of bond mutual funds (e.g., advantages and disadvantages, loads, share classes, fees, and fund categories).

Chapter 17, *Bond Funds: A Taxing Matter*, examines bond funds from the point of view of their tax status. Specific types of bond funds that are discussed include taxable and tax-exempt money market funds, high-yield (junk bond) funds, corporate and government bond funds, GNMA (Ginnie Mae) funds, and target date funds. *Choosing a Bond Mutual Fund or ETF* is the title of Chapter 18. Here readers learn about online search tools such as Morningstar and Yahoo! Finance Mutual Fund Screener available at http://finance.yahoo.com/fund. The authors also restate their opinion that they do not recommend bond funds but nevertheless provide guidelines in the book because they know many investors buy them.

The Richelsons begin Chapter 19, *Financial Planning Framework for Investing*, with "Like Rodney Dangerfield, bonds get no respect" and then counteract it with, "We believe that plain vanilla bonds have proven themselves to be the best investments available" (p. 387). This chapter discusses how to create cash flow with bonds and describes a series of "Richelson Rules" that flesh out the details. A four-step financial planning process is also explained: a) determine your life objectives and financial needs, b) divide your investment portfolio into two parts: high quality bonds and all other investments, c) maximize after-tax returns by deploying investments in appropriate accounts, and d) purchase categories of bonds in appropriate accounts to generate cash flow to meet your life objectives.

In Chapter 20, the authors' rules are fleshed out with eight different case studies that illustrate the use of bond investments to meet various investor objectives. This chapter will be of particular interest to financial educators looking for stories to illustrate subject matter content. Among the case studies are two 60-year old baby boomers on the cusp of retirement, a high-earning lawyer seeking to transition to a less stressful job, a woman transitioning through a divorce settlement, a worker with stock options, and a young couple seeking to invest for their children's education. It was clear that the authors wanted to present bonds as a viable option for a variety of financial goals and lifecycle stages and they succeeded.

Chapter 21 is titled *How to Make the Most Money from Bond*s. The authors generally endorse a buy and hold strategy. They note, however, that there may be times when it may be financially necessary or strategically advantageous to buy or sell bonds to profit from changes in interest rates. Three types of yield curves are presented that plot interest rates with maturity dates: ascending, flat, and inverted. The authors note that yield curves provide valuable insights for buying and selling decisions. For example, with an inverted yield curve (where bonds with a short maturity have a higher yield than long-term bonds), an actionable strategy is to buy short-term bonds for quick cash needs and bonds within a 5- to 10-year range to balance longer bonds in a bond ladder.

With an ascending yield curve (bonds with the shortest maturities have the lowest yields), an actionable strategy is to "consider buying longer-term bonds to capture the additional yield while staying within the parameters of your bond ladder" (p. 445). Also discussed in this final chapter are investment strategies when interest rates are high or rising and low or falling, investing for the highest after-tax yield, placing bonds in tax-effective accounts to minimize taxes, and how to create a bond ladder. The Richelsons suggest a bond ladder to reduce market risk: "Laddering a portfolio means you buy and hold a number of different bonds that will come due over a number of years" (p. 465). It provides flexibility by providing investors with access to their money and opportunities to reinvest at regular intervals.

After finishing *Bonds*, I first wondered if I had been too enthusiastic about stocks in the past in my teaching and writing. I do not think so. I certainly knew about the "lost decade" of the 2000s and common stock market risks. I also thought about the average annual returns of various asset classes contained within the Ibbotson data that I have presented for decades and the miniscule current returns being paid on many fixed income securities. I concluded, personally, that there is a place for both stocks and bonds in my portfolio. I will double check the "balance" of future investment presentations, however, to make sure that bonds get a thorough review.

I had two additional reactions to *Bonds*. First, if every investor invested totally in bonds, as the authors suggest, what would happen to the stock market, which is predicated on ongoing supply and demand? Second, while the Richelson's bond investment strategy certainly provides a measure of certainty and risk reduction, what is the long-term opportunity cost of shunning investments in equities? Their strategies may be useful for older investors who are trying to preserve wealth following decades of asset accumulation with a diversified portfolio, but could be very limiting for 20 and 30-somethings with a time horizon of four or five decades.

No matter how they feel about an "all bonds investing" strategy, financial practitioners will find *Bonds* to be a useful tool for preparing presentations and publications and answering consumer/client questions. It is a "one-stop read" for everything having to do with fixed-income securities. Each chapter is meticulously researched with extensive end notes and the two case study chapters provide real life examples of the use of bonds to meet investor objectives. Helpful tables and graphics are sprinkled throughout the book such as a list of bond rating agencies and their ratings. The book also includes an Appendix, *Useful Web-Sites* that provide additional information for readers.