

# Lowly Analyst Free Newsletter

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## The Market

The current bear rally has run up about 10% and is continuing. We expect several more bear rallies, like a roller coaster. This is a good time for [low volatility investing](#) for asset preservation.

In March many fixed income investments had attractive returns. Preferreds did well.

The US currently has [deflation](#) due to low oil and housing costs, even as inflation is waiting in the wings.

The world and the US are in a recession. Many countries including the US are starting to erect trade barriers and devalue their currencies.

This is a good time to think about taxes. If you have losses in taxable investments, consider buying bond funds (not individual bonds) and selling them before the record date in order to capture interest as an increase in net asset value. The result is a capital gain that can offset your losses. You can buy back the fund the next day. The [wash sale rule](#) applies only to losses.

Currencies. In March, New Zealand up 12%, Sweden 10%, Australia 9%, Mexico 8%, Russia 6%, S Africa 5%, Brazil 5%, Euro 5%, Switzerland 3%, India 3%, Canada 1%, United Kingdom 0%, Yen down 2%, US -3%.

Asset Classes. In March, Mid Growth up 9%, Small Value 9%, Small Growth 8%, Large Growth 8%, Mid Value 8%, Large Growth 8%, Micro Cap 8%.

Sectors. In March, Financial Srv up 17%, Clean Energy 15%, Basic Materials 15%, Technology 15%, Software 15%, Financials 13%, Covered Calls 13%, Steel 12%, Semiconductors 11%, RAFI Telecom 10%, Cnsmr Srv 9%.

Foreign Investments. In March, S Korea up 31%, S Africa 21%, Russia 21%, Australia 19%, Taiwan 17%, China 17%, Pac-J 16%, India 15%, Germany 11%, Euro 50 11%, Brazil 10%, World-US 10%, Lat Am 10%, US 8%.

Fixed Income. In March, Financial Preferreds up 28%, S&P Preferreds 21%, Covered Calls 13%, Int Gvrnt Infaltion Protcted 6.2%, 29+ Yr Treas 4.0%, 7-10 Yr Treas 3.3%, Emrg Gvmt 3.1, Hi Yld 2.0%, Mrtg Backed 1.3%, GNMA 1.2%, PIMCO Total Rtrn 1.2%, Total Bond Mrkt 1.1%, Munis 1.1%, Shrt Term Munis 0.7%, 1-3 Yr Treas 0.5%, Invstmt Grd Crp 0.5%, Tax Free Weekly 0.1%.

## Short-Term Bonds

### 1. Introduction

This is still a time to preserve assets. One way to do so is with short-term bonds.

### 2. Characteristics of Short-Term Bonds

We extend the term short-term bonds to [fixed investments](#) that provide a regular fixed return and have a maturity of less than 3 years. While the income is typically fixed for a period of time, the value or price fluctuates between issuance and maturity. If interest rates go up, bond prices go down. If rates go down, bond prices go up.

For individual investors short term fixed income consists of money market funds, investment contracts (e.g., income funds of 401(k) plans), certificates of deposits, t bills, notes, bonds of governments, corporate bonds, and municipal bonds.

There are two ways of buying bonds: buying individual bonds, or buying a portfolio of bonds via mutual funds; [Exchange Traded Funds \(ETFs\)](#), or [Exchange Traded Notes \(ETNs\)](#). With individual bonds the holder will receive the full value of the bond at maturity. A fund however has no maturity. At any time a fund can be sold at the current net asset value that can be more or less than the purchase price. If interest rates go down, the fund increases in value; if interest rates go up, the value decreases.

For most individuals it is better to invest in [bond funds](#) rather than individual bonds. Funds are diversified, can be bought and sold at any time, in any amount, and dividends can be reinvested. Bonds are generally very expensive to trade.

Historically, US short-term bonds have increased their purchasing power 0.5% (US stocks 7.5%) and have a volatility of 6% (stocks 18%).

Bond yields, interest rate, default, and reinvestment risk typically increase with maturity, while volatility decreases. Reinvestment risk is the risk that dividends can be reinvested only at a lower rate than the original bond.

If possible, you should hold bonds in taxable accounts because bond interest generally has a low tax rate (Munis are tax exempt). This advantage disappears in an IRA.

The tables below show the standard deviation (SD), the RiskGrade (Risk), the yield (Yld), the return divided by risk (Rt/Rsk), and returns for 1, 3, and 12 months for some US Short-Term Bond Funds, ETFs and ETNs. The graphs show the price over time for the last year.

### 3. US Government Short-Term Bonds

Traditionally US government bonds were the safest investment and paid the lowest interest rates.

#### Wells Fargo Advantage Sh Dur Govt Bd Adm (MNSGX)

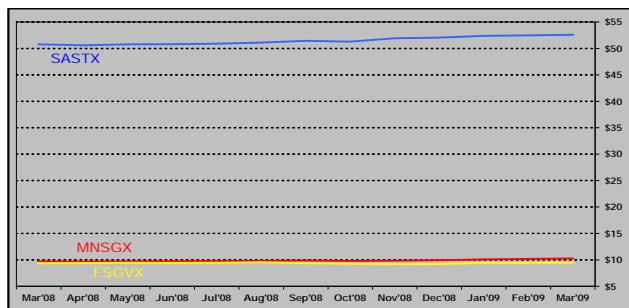
SD	Risk	Yld	Rt/Risk	1 Mo	3 Mo	1 Yr
1.7%	10	4.2%	53%	1.2%	3.3%	5.3%

#### Federated U.S. Govt: 1-3 Yr Instl (FSGVX)

SD	Risk	Yld	Rt/Risk	1 Mo	3 Mo	1 Yr
1.2%	11	3.1%	10%	0.1%	4.0%	1.1%

#### Calvert Short-term Government I (SASTX)

SD	Risk	Yld	Rt/Risk	1 Mo	3 Mo	1 Yr
1.4%	5	0.4%	66%	0.3%	0.3%	2.6%



### 4. Short-Term Corporate Bonds

Short-term corporate bond funds invest in corporate bonds of a variety of ratings, high yield / high risk bonds, floating rate securities, bank loans, dollar-denominated obligations issued in the U.S. by foreign governments and corporations, U.S. Government and Government related entities, and preferred shares. Not all of them can invest in all of these securities. Some funds try to track indexes. Some can borrow small amounts of money, and thus are slightly leveraged.

In most cases (but not always) corporate bonds have higher risks, yields, and returns than government bonds. Currently investors are very risk averse. This raises the price of government bonds and depresses the price of corporate bonds.

#### Transamerica Short-Term Bd A (ITAAX)

SD	Risk	Yld	Rt/Risk	1 Mo	3 Mo	1 Yr
2.1%	9	4.0%	-32%	0.5%	3.1%	-2.8%

#### Evergreen Adjustable Rate Instl (EKIZX)

FSD	Risk	Yld	Rt/Risk	1 Mo	3 Mo	1 Yr
1.1%	14	3.2%	-3%	1.0%	2.8%	-0.5%

#### Federated Short-Term Income Instl (FSTIX)

SD	Risk	Yld	Rt/Risk	1 Mo	3 Mo	1 Yr
0.9%	12	4.3%	-5%	0.5%	2.6%	-0.6%

#### USAA Short-Term Bond (USSBX)

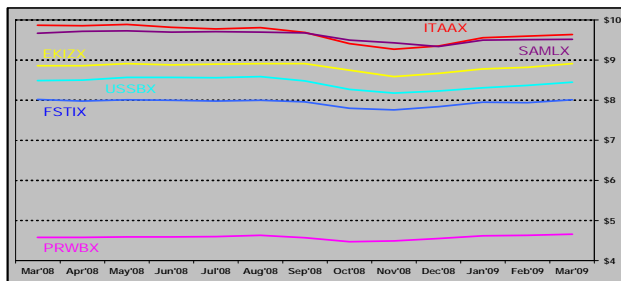
SD	Risk	Yld	Rt/Risk	1 Mo	3 Mo	1 Yr
1.6%	15	4.9%	-9%	1.0%	2.7%	-1.4%

#### RidgeWorth Limited Duration I (SAMLX)

SD	Risk	Yld	Rt/Risk	1 Mo	3 Mo	1 Yr
1.3%	9	0.0%	-20%	0.2%	1.9%	-1.8%

#### T. Rowe Price Short-Term Bond (PRWBX)

SD	Risk	Yld	Rt/Risk	1 Mo	3 Mo	1 Yr
1.1%	13	4.2%	8%	0.6%	2.4%	2.0%



### 5. Short-Term Municipal Bonds.

Municipal bonds (Munis) are generally tax exempt from Federal taxes. Some are considered private activity bonds and are subject to AMT.

Interest income is generally exempt from state and local taxes for residents of the same entity as the issuer, but a small number of states tax even their own bonds. NY State bonds are tax exempt to NY residents.

The discount of bonds bought after issuance is taxable as ordinary income, unless the discount is small and falls under the *de minimus rule*. E.g. a \$5 discount on a \$1000 bond, 2 years before maturity, would be taxed as capital gains, not ordinary income, if the bond is later sold or redeemed at \$1000. Your broker's 1099 will tell you if the rule applies.

Some municipal bonds are insured as to interest and principal. The insurance is only as good as the insurance company.

#### Wells Fargo Advantage S/T Muni Bond Inv (STSMX)

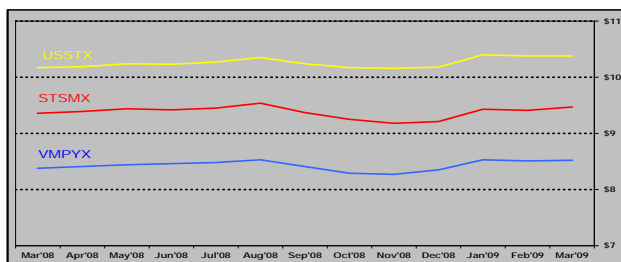
SD	Risk	Yld	Rt/Risk	1 Mo	3 Mo	1 Yr
1.2%	10	4.2%	10%	0.2%	2.8%	1.0%

#### USAA Tax Exempt Short-Term (USSTX)

SD	Risk	Yld	Rt/Risk	1 Mo	3 Mo	1 Yr
0.9%	7	4.4%	32%	-0.2%	2.0%	2.3%

#### Evergreen Strategic Municipal Bond I (VMPYX)

SD	Risk	Yld	Rt/Risk	1 Mo	3 Mo	1 Yr
1.1%	8	4.0%	22%	-0.1%	2.0%	1.3%



### 6. Bottom Line

- Short-term bonds have lower return and lower risk than stocks.
- Short-term bonds currently provide a total annual return of 0 - 6% per year.
- There is no consistent difference in short-term returns of funds of government, corporate and municipal bonds.
- Investors should hold fixed income in taxable accounts, instead of tax deferred accounts, as much as possible.