



BOND LADDERING

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I. How Does a Bond Ladder Work?

A bond ladder works by spreading investment dollars among bonds that will mature at various times between one and thirty years from now. In a normal interest rate environment, shorter maturities will yield less than longer maturities. Think of the individual bonds as rungs on your ladder. As each individual bond (rung) matures, your principal is made available for reinvestment at current interest rates.

The value of a ladder is the ability to reinvest the principal from the maturing bond (bottom rung) into a longer term bond with a higher yield. The new bond will then become the new top rung of your ladder.

Another advantage of using the ladder strategy is that you can customize your ladder to suit your individual investment objectives, such as meeting future funding needs or fulfilling specific income requirements. Investment selection will also take into account such things as your tax liabilities, quality considerations and anticipated future changes in your financial situation.

Ladders are typically built using a variety of the following types of fixed income securities: U.S. Treasury and government agency securities, tax-exempt municipal bonds, corporate bonds, zero-coupon bonds, certificates of deposit,¹ Ginnie Mae pass-through securities and collateralized mortgage obligations (CMOs).

¹ CDs are FDIC-insured up to \$100,000 and their yield and principal are guaranteed if they are held to maturity.



II. Why Use a Ladder?

It's a Strategy for All Interest Rate Environments.

Since a bond ladder enables you to reinvest your assets periodically over time, your portfolio will be less affected by interest rate volatility. This concept is similar to dollar cost averaging in stocks. As bonds come due, you are able to reinvest your principal into bonds of intermediate or longer term maturities, where the yields are higher.

Interest rate changes will affect you less with a bond ladder. Here's why:

- If interest rates go down over the next few years, you will already have locked in higher rates — and the current market value of your fixed income portfolio will be rising.
- If interest rates stay the same, you will be earning longer term yields, so your return should exceed what you would be earning if you left your investment short term.
- If interest rates go up, the current market value of your fixed income portfolio will be falling. However, as each rung on the ladder matures, you will have money to invest at higher rates.

III. The Benefits of Building a Ladder

Diversification

The ladder approach allows you to be invested in a variety of bonds to provide diversification, reducing both credit risk² and reinvestment risk.³ In addition to selecting a number of different maturities, you can select from a variety of investment types or quality ratings.

Higher Yield

Many investors have an aversion to buying longer term bonds. However, in a normal rate environment, intermediate and longer term securities offer higher returns than short term securities. The liquidity and diversification provided by a well-structured ladder will enable you to include longer, higher-yielding securities to potentially increase the overall return of your portfolio.

Investors should be aware of the call features on their bonds and how they may negatively affect the structure of the ladder portfolio. While callable bonds do offer higher rates of return than comparable non-callable bonds, you need to diversify your callable bonds carefully. Even though your callable bonds may have staggered final maturities, if all your bonds are callable at the same time and rates happen to be lower at that time, your bonds could be called. You would then have to reinvest at lower rates. Your Financial Advisor can structure your portfolio to include non-callable bonds or stagger the call dates to help protect you from reinvestment risk.

² Credit risk refers to the risk of the issuer failing to make timely payment of principal and interest.

³ Reinvestment risk is the risk that you may have to reinvest proceeds at a rate below that of the original investment.



Liquidity

With a ladder, bonds will be maturing regularly. Proceeds can then be reinvested in the ladder or taken out in cash if needed.

Quality

Because you have a ladder with diversification, you can afford to vary the quality of your portfolio, hopefully increasing your yield. Remember, the overall quality of your bond ladder should be dictated by your individual risk tolerance.

Stability

In periods of rising interest rates, a bond ladder offers greater protection from declining market value than a portfolio consisting solely of long term bonds. In periods of declining rates, your ladder rises in value — and you still have the higher rates already purchased.

Customization

You are in the driver's seat with your bond ladder program. Your bond ladder can be designed today to help meet your current financial needs, whether for savings or income generation. Laddering a portfolio is a dynamic process that gives you the opportunity to restructure as your needs and objectives change in the future — such as systematically moving from tax-exempt to taxable investments upon a change in your tax status.⁴

⁴ Our firm does not render legal, accounting or tax advice. Please consult your tax or legal advisors before taking any action that may have tax consequences.

IV. How Could a Ladder Help Meet Your Needs?

- Zero-coupon Treasury bonds maturing in August of each of the years of a child's or grandchild's private school or college education.
- For clients in higher tax brackets, a tax-exempt municipal ladder will provide for exemption from Federal income taxes.⁵
- Pass-through securities (Ginnie Maes) or Collateralized Mortgage Obligations (CMOs) to provide monthly income with the credit assurance of government agency issues.
- Pension and profit-sharing or IRA accounts.
- Treasury notes for endowment funds.

V. Conclusion

A bond ladder can be a valuable addition to your fixed income portfolio. Your Financial Advisor can help you determine whether a bond ladder will fit your investment objectives and which types or structures best suit your investment needs. He or she can also advise you on the timing of your investment, and on the issues and maturities that are most appropriate in meeting your investment objectives.

⁵ Income may be subject to state or local taxes or alternative minimum tax (AMT).