

Index:	23,516.26	9.420%
Cap:	N5.34trn	9.42%
Volume:	1.46 bn	-6.4%
Value:	N10.41	-9.47%

I never hesitate to tell a man that I am bullish or bearish. But I do not tell people to buy or sell any particular stock. In a bear market all stocks go down and in a bull market they go up – Jesse Livermore



## Fixed Income Mutual Funds: What are they?

A fixed-income investment is an investment that provides a return in the form of fixed periodic interest payments and the eventual return of principal at maturity. Unlike a variable-income security, where payments change based on some underlying measure such as short-term interest rates, the payments of a fixed-income security are known in advance.

An example of a fixed-income security would be a 10% fixed-rate bond where a N10,000 investment would result in an annual N1,000 payment until maturity when the investor would receive the N10,000 back. Generally, these types of investments offer a lower return on investment because they guarantee income.

Like stocks, investors have the choice of accessing fixed income investments either directly – by buying individual instruments such as bonds, treasury bills, among others; or indirectly through fixed income mutual funds such as bond funds etc.

### Bond Mutual Funds

A bond fund pools money from many investors to buy individual bonds that meet the fund's investment objective. There are many types of bond funds, each categorized based on the type of bonds in which it invests such as corporate bonds, municipal bonds, government-agency bonds and so on.

### Risks of Bond Funds

As with any investment, understanding the risks is very important. Bond fund risks include interest rate risk and credit risk.

#### Interest Rate Risk

If interest rates rise, generally, bond prices usually decline, and if interest rates decline, bond prices usually rise. This inverse relationship is important to understand. The longer a bond's maturity, the greater the interest rate risk. A bond fund with a longer average maturity will see its net asset value (NAV) react more dramatically to changes in interest rates as the prices of the underlying bonds in the portfolio increase or decline. The effect that interest rates have on the prices of bonds owned by the fund will cause the income that the fund distributes each month to vary.

#### Credit Risk

Bonds carry the risk of default, meaning that the issuer is unable to make further income or principal payments. Many individual bonds are rated by a third party rating agency to help describe the credit worthiness of the issuer.

Bond funds are typically classified as investment grade-quality (medium – high credit quality) or below investment grade-quality, depending on the individual bonds in which they invest. Credit risk is a greater concern if the fund invests in lower-quality bonds such as high yield bond funds. The fund's prospectus will describe its credit quality policies.

Other risks, such as default risk and call risk, are typically mitigated because a bond fund is made up of many individual bonds. By owning a large number of bonds, the impact of any one bond defaulting or being called away prior to maturity (forcing the fund to reinvest the proceeds at a lower, prevailing rate of interest), is lessened.

### Advantages of Bond Funds

- Diversification – Bond funds normally own a number of individual bonds of varying

maturities, so the impact of any one single bond's performance is lessened if that issuer should fail to pay interest or principal. Certain types of bond funds, such as broad market bond funds, are also diversified across bond sectors, providing exposure to corporate, government, government agency and mortgage-backed bonds.

- Professional management – Professional portfolio managers and analysts have the expertise and technology to research the creditworthiness of bond issuers and analyze market information before making investment decisions. Fund

- Regular income stream – Most bond funds pay regular monthly income, although the amount may vary with market conditions. This feature can make bond funds an appropriate choice for investors who desire somewhat stable, regular income. If you do not wish to receive the monthly income, you can choose to have your dividends reinvested automatically as one of several dividend options.

- Potential for tax-free income – Many investors use municipal bond funds to help reduce their tax burden. Although municipal bond yields are generally lower than taxable

expenses of bond funds, they do have associated expenses including brokerage commissions/fees and bid-ask spreads that all investors should consider. Furthermore, retail investors get less favorable pricing (commissions and bid/ask spreads) than institutional investors. The costs of trading individual bonds are very hard to accurately pin down and commissions are never fully disclosed. If ever there was an area for institutional traders to make obscene profits in the markets, it's the bond market.

When you purchase a bond fund, you know what the cost will be: a transaction fee and the expense ratio.

### Safety

Many investors are under the impression that owning bonds is a risk-less transaction. That is a myth that results in a false sense of security. The fact is that bonds, whether corporate or treasury respond to daily changes in interest rates as well as credit conditions. Individual bond investors might take comfort in knowing that at the end of the maturity period, their principal will be returned. However, throughout the maturity period, their principal will fluctuate. As interest rates rise, bond principal will go down (since the bonds become less attractive to new investors). If the owner of the individual bond feels compelled to sell their position before the maturity date, they may likely take a loss during a period of rising interest rates.

Bond funds are much more liquid. Granted, bond funds do not have a fixed maturity (meaning principal nor income is guaranteed). But, fund managers are constantly buying and selling bonds within the portfolio in order to maximize interest income and capital gains.

### Performance of a Bond Fund

Because the performance of a bond fund is determined by the performance of its underlying investments, it may be helpful to review the basics of bond fund investing before looking closely at fund performance. However, past performance is not a guarantee of future results.

### Unit Price

Every bond fund has a net asset value (NAV), or share price, which is the Naira value of one fund share. The NAV is based on the value of all the securities in the portfolio and typically fluctuates daily.

### Total Return

A bond fund's total return measures its overall gain or loss over a specific period of time. Total return includes income generated by the underlying bonds themselves and price gains or losses of the bonds in the portfolio. Investors should focus on total return when evaluating performance of bond funds.

In conclusion, there are distinct benefits to owning bond funds in lieu of individual bonds.

Despite their ongoing expense, bond funds provide a better alternative in terms of diversification, liquidity, and the availability of reinvesting dividends. A low cost bond index fund will help you achieve the portfolio risk control you need. Remember, just as with equity investments, the more broadly you diversify, the better results you will attain.

Year	Amount	State	Purpose
1999	N1bn	Edo	Housing
2000	N3.5bn	Delta	Various Projects
2001	N2.5bn	Yobe	Various Projects
2002	N4bn	Ekiti	Various Projects
2002	N15bn	Lagos	Various Projects
2003	N4bn	Cross River	Tourism (Obudu Ranch)
2004	N6bn	Akwa Ibom	Various Projects
2006	N2.5bn	Kebbi	State University and irrigation project
2008	N275bn	Lagos	Roads etc

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managers identify which securities to buy and sell through individual security analysis, sector allocation, and yield curve positioning.

- Liquidity and convenience – Bond funds allow you to buy or sell your fund shares each day. In addition, bond funds allow you to automatically reinvest income dividends and to make additional investments at any time. For most bond funds, the minimum initial investment amount may be substantially less than what you would have to pay for a diversified portfolio of individual bonds. Depending on market conditions when you withdraw funds, your principal may be higher or lower than your initial investment.

bond fund yields, some investors in higher tax brackets may find they earn more from a tax-free, municipal bond fund investment instead of a taxable bond fund investment with a higher yield.

### Should You Invest in Individual Bonds or Mutual Funds?

Before we can answer the question “should you invest in individual bonds or bond mutual funds”, we have to first understand the purpose of owning bonds in your portfolio. Novice investors use bonds as an income generator, relying on yields to supplement living expenses during retirement. Institutional investors and competent advisors, on the other hand, view bonds as a tool to reduce portfolio volatility. Total return, not just bond yield, is what counts. If the purpose of holding bonds is to control portfolio risk, then owning bond funds, not individual bonds, is the appropriate choice.

### Price

Individual bonds are not cheap. A single corporate bond can cost as much as N50,000 or more.

The higher costs associated with acquiring individual bond issues may prevent many investors from sufficiently diversifying among different issues.

On the other hand, though an initial investment in a bond fund might cost N50,000 you will be buying into many different bonds instead of buying one individual bond for the same cost. As a bond fund holder you can own stakes in dozens, perhaps hundreds, of bonds with one purchase.

### Costs

While individual bonds do not incur the ongoing management and operating