

Averting Subprime Impact In Fixed Growth Investments

What's the fallout of the subprime debacle?

In the past year we've witnessed to date nearly \$100 billion in losses or write-offs at the world's largest financial corporations, the removal of a handful of major corporate leaders from their jobs, the eradication of billions of dollars of stock market value, and the tainting of professional credibility at top credit rating agencies.

Sometimes the fallout has made headlines, but for a different type of reason.

The New York Times recently detailed the financial plight of an Indianapolis non-profit agency which lost \$48,000 in a regional brokerage firm's bond fund. That fund, over-invested in risky and illiquid mortgage-related securities, lost nearly 50 percent of its \$1 billion value in the last nine months of 2007. To the non-profit, dedicated to the fulfillment of wishes of critically ill children, the loss meant the wishes of nine children would not have been granted by the agency, had the brokerage house not settled the arbitration claim of the organization.

In the state of Florida last fall, a state-operated pooled investment fund for local governments and school districts was forced into a withdrawal moratorium when the fund, once valued at \$27 billion, disclosed that \$2.3 billion of that number was tied to subprime mortgages. School districts and municipal governments quickly withdrew \$10 billion over a two-week period, until halt of withdrawals was declared. Other states – Maine and Montana -- also have found themselves in the position of having illiquid mortgage-backed securities.

As the front-wave of the Baby Boom generation approaches retirement, and creates an increased need for income-generating investments, what can individual investors do when the professionals are struggling with reward versus risk? The answer lies in a return to basics.

Know exactly what you're buying. When investors reach for yield to fulfill their income needs, they need to recognize immediately that if a bond is yielding more than the market there is a reason for that situation. As many of us learned from our parents "If it seems too good to be true it is." Generally speaking, it's very difficult to know on a detailed level what bonds are held by bond funds.

Know the issuer. As a bond holder an individual investor is making a loan to the issuer of the bonds. If you're investing in municipal bonds, know the government agency that's issuing the bonds. If you're interested in corporate bonds, ascertain the financial position of the company in which you're investing. Seek underlying qualities that aren't necessarily discernable in an AAA rating.

Use treasury bonds as your gauge for the risk/reward of an investment. If an investment under consideration is paying more than current treasury bond levels delve into the explanation for that circumstance. Treasury bills are considered to be zero credit risk.

Diversify as you would with your stock portfolio. If you're going to hold bonds, make sure they're varied to spread your risk across that portion of your investments.

Shop around for bonds. Prices can vary for bonds, and not every seller of bonds offers the same bonds. Does the person selling you the bonds have a great deal of

experience as well as a broad range of offerings? What is their fee, if any, for selling you the bonds? What other fees are being paid through your purchase of the bonds? Are the bonds callable, and if so how likely are they to be called? Can that situation work to your advantage or disadvantage as an investor?

As a general working rule, don't take risks in your portfolio with bonds. A perfect example of this can be found in the above cited situation in Florida. That pooled fund's managed returns through September were 5.56 percent. Its benchmark for the same time frame returned 5.51 percent. For .05 percent, that pool's managers incurred a lot more risk – and losses – to the municipalities and school districts that were investors.

Make sure your expectations are aligned with the market. What you as an investor need to sustain your lifestyle or anticipated portfolio growth, and what the market is currently yielding may be not at similar levels. The question then becomes whether you adjust your portfolio and absorb more risk – and potentially loss – or whether you adjust your understanding of the market, and correspondingly your lifestyle.

Better yet, hire a professional investment manager with a long, conservative track record of managing fixed income or bond portfolios.

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