

EXCERPT FROM *BONDS NOW!*

TAKEN FROM: CHAPTER 8: HOW TO BUY AND SELL BONDS

Without Being Taken To the Cleaners

Be a Bond Collector

Some people collect stamps, some collect watches. Individual bond investors collect bonds. Just as a stamp collector targets specific issues, countries and eras, bond collectors also have specific holes to fill in their collections. That's why bond investors buy and sell their bonds. They may need a particular maturity to fill a hole in their maturity ladder. They may need a municipal bond issued by their state of residence to generate tax exempt income. They may need to sell a bond that looks like its issuer is about to be downgraded to a level that no longer fits their risk profile. All are valid reasons to execute a bond trade.

Figuring out what you need (and no longer need) in your bond collection is half the battle. Remember *El Greedo* from Chapter 5? It cost *El* \$1 million to learn how to buy and sell bonds. In the end he finally got it. A costly education to be sure. However, without learning the collector's discipline, *El* would have likely lost more.

Action Step: Bond Selection

No self respecting stamp collector would ever leave selection of his next purchase up to a stamp salesman. Same thing with bonds. Never leave selection of the type of bond to the broker. He likely doesn't know what's already in your bond portfolio. Further, he couldn't care less if you achieve your fixed income investment goals. Selling a bond to a customer means the broker won't see that money again for years. Whereas with equities

they can rotate customers in and out of stocks all year long and generate a continuing stream of commissions.

Allowing the broker to sell you a bond puts you in a passive role. We professionals never take a passive role when trading bonds. Neither should you. Acting as the participating, engaged buyer makes all the difference. As the bond investor, you want to be an integral part of *your* transaction. Be a proactive buyer.

Select specific bonds to do a particular job in your portfolio. For some it may be a steady, stable income stream. For others it is safety of principal. Other bonds in your portfolio offer some upside potential in the event interest rates fall.

When *El Greedo* rebalanced his portfolio he knew just where he wanted to allocate his bond investments. A certain percentage was going to the energy sector, the food sector, the retail sector and so on. Within those sectors he chose specific companies that met his criteria. Within those companies he went on to select particular maturities to guarantee him the income stream he needed. He knew exactly what bonds he needed to fill in his collection. When *El* picked up the phone to call his broker, the conversation was pretty one sided:

El: “I need 50 Conagra Notes 5.875% due 04-15-14. CUSIP number is 205887BE1. Here’s my bid _____.”

Broker: “Good morning to you too, Mr. Greedo. Yes sir, Mr. Greedo, I’ll see what I can do.”

This is the difference between a savvy investor who is buying what he needs versus someone who is shopping and willing to be sold whatever the broker has on the shelf at the time. Now, *El* already knew the price at which his bonds were trading from looking at the TRACE system. That’s how he knew where to bid. We’ll show you the mechanics of TRACE later in this chapter. Additionally, he will have the same conversation with at least one other broker. Further, *El* has already decided to walk if the market runs away from his bid (rises too far above the bid).

The value your broker adds to the deal and the reason why he earns his commissions with a savvy investor--opposed to taking his commission from a less astute investor--is in working the transaction. He may be unable to find the Conagra bonds at the price *El* specified. He will likely recommend another bond in the same sector with relatively the same yield

and maturity date that he can get. His worth as a broker lies in his ability to hit your bid with a fair price and do it quickly.

You know your bond collection and requirements better than your broker. Therefore you should be the one telling the broker what you will buy.

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