Understanding Bonds

There are certain things you must understand about bonds before you start investing in them. Not understanding these things may cause you to purchase the wrong bonds, at the wrong maturity date.

The three most important things that must be considered when purchasing a bond include the par value, the maturity date, and the coupon rate.

The par value of a bond refers to the amount of money you will receive when the bond reaches its maturity date. In other words, you will receive your initial investment back when the bond reaches maturity.

The maturity date is of course the date that the bond will reach its full value. On this date, you will receive your initial investment, plus the interest that your money has earned.

Corporate and State and Local Government bonds can be ‘called’ before they reach their maturity, at which time the corporation or issuing Government will return your initial investment, along with the interest that it has earned thus far. Federal bonds cannot be ‘called.’

The coupon rate is the interest that you will receive when the bond reaches maturity. This number is written as a percentage, and you must use other information to find out what the interest will be. A bond that has a par value of $2000, with a coupon rate of 5% would earn $100 per year until it reaches maturity.

Because bonds are not issued by banks, many people don’t understand how to go about buying one. There are two ways this can be done.

You can use a broker or brokerage firm to make the purchase for you or you can go directly to the Government. If you use a brokerage, you will more than likely be charged a commission fee. If you want to use a broker, shop around for the lowest commissions!

Purchasing directly through the Government isn’t nearly as hard as it once was. There is a program called Treasury Direct which will allow you to purchase bonds and all of your bonds will be held in one account, that you will have easy access to. This will allow you to avoid using a broker or brokerage firm.

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