Your Money

Bonds Or Bond Funds: What's The Difference?

(NAPSA)—Learning more about the differences between bonds—and the risks involved—can help you decide which is right for you.

For example, investing in a bond mutual fund or bond exchange traded fund (ETF) is not the same as investing in an individual bond. Both investments can be used to accomplish a variety of investment objectives—and both carry risks.

A bond is a loan that an investor makes to a corporation, government, federal agency or other organization. But a bond fund is a pooled investment—usually a mutual fund or an ETF—that invests primarily in bonds. Bond investments will fluctuate—and may decline—just as they do if invested in a stock mutual fund.

With a bond fund, the value of your investment fluctuates from day to day. While this is also true of individual bonds trading in the secondary market, if the price of a bond declines, you always have the option of holding the bond until it matures and collecting the principal. Here are four factors to consider when deciding:

1. Return of Principal. Unless there is a default, when an individual bond matures or is called, your principal is returned. That is not true with bond funds.

2. Income. With most fixed-rate individual bonds, you know exactly how much interest you'll receive. With bond funds, the interest you receive can fluctuate with changes to the underlying bond portfolio. Many bond funds pay interest monthly as opposed to semiannually, as is the case with most individual bonds.

With individual bonds, don't invest based solely on yield—higher yield comes with higher risk.

3. Diversification. With a single purchase, a bond fund provides you with instant diversification at a very low cost. To put together a diversified portfolio of individual bonds, you'll need to purchase several bonds, and that might cost you $50,000 or more. Most mutual funds require a minimum investment of a few thousand dollars.

4. Liquidity. Virtually all bond funds can be sold easily at any time at the current fund value. The liquidity of individual bonds, on the other hand, can vary considerably and be more expensive to sell.

According to the financial experts at FINRA, the largest independent regulator for all securities firms doing business in the United States, when selecting a bond fund, don't focus only on the fund's performance. Instead, stick to the investment strategy that will best help you achieve your goals and objectives.

For more information, visit www.FINRA.org or call (301) 590-6500.