Stepping Up To Bond Laddering

Q. What is bond laddering?

A. Say you have $20,000 to invest now. You could invest it all in 10-year bonds, but then you'd be stuck earning today's rates until 2022, no matter how high the interest rates on new bonds went during those years. The alternative is to create a "ladder," investing equal amounts ($4,000) of your $20,000 in bonds maturing in one, three, five, seven and nine years. In a year, the first bond matures---giving you $4,000 to reinvest. If you can reinvest that money at a higher rate, you will increase the overall return on your bond portfolio. If you must reinvest at a lower rate, you still have the remaining $16,000 paying a higher rate.

Q What makes bond laddering a good investing strategy?

A. You're making a long-term commitment to bonds, but you are doing it in bite-sized increments. Given the very wide range over which bond prices---and interest rates---have fluctuated in recent years, this may be a good thing to do. By laddering, you can begin shopping for a higher return on your bonds in as short a time as a year.

Q. Can I use bond laddering in my retirement savings plan?

A. Remember that funds don't have set maturities, as individual bonds do. So you can't create a ladder with exact maturities as you can with individual bonds. Still, there may be long-term, intermediate-term and short-term funds available in your retirement savings plan. If so, you can diversify your investments by spreading your contribution over several funds, from short-term to long-term. You may earn less by buying funds of varying maturities than if you only bought a long-term fund, because long-term bonds generally pay the highest interest. But you'll manage the volatility of your portfolio by spreading your money over a variety of maturities, because volatility is generally highest for long-term bonds, but less for bonds issued for shorter terms.

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