To Your Wealth®

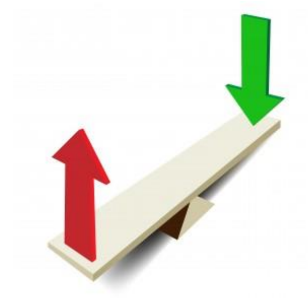
FINANCIAL SERVICE GROUP INC.

August 2013

Why bonds lose value

As published in the Racine Journal Times | August 1, 2013 | by Justus Morgan, CFP®

You may have been surprised in the past month when you opened your retirement or investment account statement to see you lost money in your bond funds. While it's true that bonds are typically safer than stocks, this doesn't mean they are immune from losses.



The primary cause of the losses was the increase in interest rates in June. A reasonable belief is that rising interest rates should be good because you will earn more interest, right? Not exactly. There's a relationship between bond prices and interest rates which means that as rates increase, bond prices go down (with a few notable exceptions such as Savings Bonds). If you're confused, you're not alone.

Remember that bond funds are just a collection of individual bonds issued by companies or governments. A bond is basically an IOU where you earn interest and receive your original money back at a predetermined date in exchange for lending the money to a borrower now. A simple example may help to understand why your bond fund lost money this year.

Imagine you own a bond paying two percent interest that you bought a couple years ago. I want to buy a bond and can either buy yours or buy a new one being issued today at three percent. All else being equal, why would I buy the bond you have at two percent when I can just buy a new one at three percent?

The answer lies in the price of each bond. If the new bond costs $100, you might be willing to sell me yours for $98. Even though the interest rate on your bond is less, it doesn't cost me as much so I might view that as a worthwhile deal. If you originally paid $100 for your bond and sell it now for $98, that's a $2 (or two percent) loss! Multiply this by thousands of dollars and you can see why the value of your bond fund declined. Your old bonds are paying less than the new ones, so the price goes down to make them attractive to potential buyers based on current interest rates.

If you're concerned about future increases in interest rates which could lead to further declines in bond prices, one strategy to minimize losses is to own shorter maturity bonds. Shorter-term bonds tend to fluctuate less as rates rise.

Think of money market funds as the ultimate short-term bond with maturities measured in days versus years. The tradeoff is the interest rates earned on the short-term bond funds will be a fraction of a percent. No matter what you decide to do, you'll now know what to expect in the future when rates increase.

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Pesky papers piling up? Drop them off at FSG!

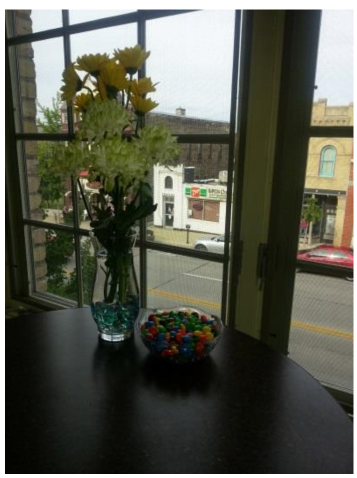
Do you have confidential, yet unnecessary papers to rid yourselves of, but you don't want to risk simply throwing them in the garbage? FSG uses a certified records destruction company and we offer free shredding services throughout the year to our clients.

On September 13, FSG will have a fall clean-up day at our office between 9 a.m. and 2:30 p.m.   Feel free to load up your bags of piled up papers and drop them off at our office for appropriate and secure disposal. And remember, this service is available to you at any time during the year.

Out and about

This year's First Friday event was held on August 2 and was another great success. Thanks to all of you who stopped by to say hello and enjoy some summer "spirits" at UnCorkt with food catered by Ivanhoe.

Special thanks also to those who brought friends or family members to meet us!



Team FSG did their part to help support the Midwest Athletes Against Childhood Cancer (MACC Fund) by sponsoring two holes at the Bob & Brian/HOG 102.9 Open at the Grand Geneva Resort on July 26.

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