What is a bond ladder?

A bond ladder is a strategy for managing fixed-income investments, such as certificates of deposit (CDs), U.S. Treasury notes and bonds, agency securities, municipal bonds, corporate bonds and zero coupon bonds.

To build a ladder, simply divide your investable dollars evenly among bonds or CDs that mature at regular intervals, for example, every six months or once a year.

In the example below, we divided $500,000 into five $100,000 investments, with the first bond maturing in one year and the fifth in five years.

Now let’s look at our sample bond ladder after one year.

When the first bond matures, the principal is reinvested in another bond at the long end of the ladder. This process continues year after year, as long as the investor’s goals remain the same.

As you can see, the fundamental idea behind a bond ladder is diversification by maturity. Diversification is one of the cornerstones of sound investment management.

Do you depend on your investments for income? Do you plan to help your children or grandchildren pay for college? Are you investing toward retirement or other long-term goals? Are you investing with the goal of preserving your new wealth? If your answer is yes to any of the above, our Bond Ladder Service may be an appropriate investment strategy for you.
THE BENEFITS OF A BOND LADDER

The bond ladder strategy, while simple, offers you many benefits:

Higher Average Yields
Generally, the longer a bond’s maturity, the higher the yield. A bond ladder can combine the higher yields of longer-term bonds with the liquidity of shorter-term bonds.

More Consistent Returns
If interest rates rise, your maturing bonds take advantage of improved rates. If interest rates fall, your prior laddered holdings will most likely produce more income than could be achieved at the current levels. The result is a more consistent yield.

As shown in the graph below, a one-year to five-year Treasury bond ladder smooths out interest rate cycles. With few exceptions, the graph shows the one-year to five-year Treasury ladder typically outperforming investments in three-month and six-month Treasury investments.

Lower Expenses
There are no costs other than normal commission charges or managed account fees, yet you receive many benefits. For example, our portfolio valuation service gives you a detailed analysis of your ladder’s projected cash flow and maturity schedule. Making comparisons with investment company securities requires full disclosure of all fees and expenses.

Less Reinvestment Risk
With a bond ladder, you lessen reinvestment risk—the risk that all your income assets mature when yields are lower, forcing you to accept less income or choose riskier, higher-yielding investments. A bond ladder strategy can reduce the impact of this risk. However, this requires an ongoing commitment to the program.

Added Diversification
In addition to diversifying your principal in bonds with different maturities, you can also build your bond ladder with different issuers and credit ratings. By doing so, you have the potential to benefit from the additional diversification.

Ongoing Liquidity
With a bond ladder, you’ll have one or more bonds maturing on a regular basis. You can choose to reinvest your principal in another bond or redirect the proceeds for another purpose. Should you need additional funds, liquidating your shorter maturities should have minimal impact on your portfolio’s overall yield.

Risks
Every investment involves a risk/reward trade-off. The less risk you are willing to assume, the lower the yield or return you can typically expect from an investment. Generally speaking, bond investors demand higher yields for shouldering market risk and credit risk.

Market risk is simply another way of describing the inverse relationship between bond prices and interest rates. If interest rates are rising and you don’t want much fluctuation in your bond portfolio, stay short-term. Although rising interest rates push all bond prices down, in general, the longer a bond’s time to maturity, the greater its price sensitivity. By concentrating on short-term bonds, you’ll be less exposed to market risk—a comfortable posture for many.
On the other hand, if interest rates are falling from currently high yields, income-oriented investors may want to purchase longer-term securities. This strategy allows you to own an attractive yield that may not be available in the future. Because interest rates are difficult to predict with accuracy, you may want to own short- or intermediate-term bonds (up to 10 years) and simply hold them to maturity. Bond ladders can be structured with short-, intermediate- or long-term bonds. The bond ladder concept is an excellent strategy to minimize market risk.

Credit risk is the risk that the issuer won’t make timely interest or principal payments. If you are concerned about defaults, construct your bond ladder with government securities, CDs, high-quality or insured municipal bonds, or high-quality corporate bonds. Although you may sacrifice some yield, you'll have comfort of knowing you own high-quality securities.

**TYPES OF BOND LADDERS**

**Our “Check-a-Month” Ladder**

Most bonds pay interest semi-annually, six months apart. To get a monthly check, simply invest in six bond issues, each with a different interest payment cycle.

If you anticipate annual reoccurring expenditures in certain months, you can design your ladder for more income during that period. For example, the ladder below is structured to pay more in April (for taxes) and in December (for the holidays). When one of your issues matures, we’ll help you find another issue that pays on the same schedule.

<table>
<thead>
<tr>
<th>“CHECK-A-MONTH” LADDER</th>
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<tbody>
<tr>
<td>Bonds Maturing In</td>
</tr>
<tr>
<td>1 year</td>
</tr>
<tr>
<td>2 years</td>
</tr>
<tr>
<td>3 years</td>
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<td>4 years</td>
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<tr>
<td>5 years</td>
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<tr>
<td>6 years</td>
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This chart is for illustrative purposes only and does not represent the performance of any specific investment. For added diversification and to lessen reinvestment risk, the two largest positions can be divided into $50,000 investments in different bonds to achieve the investor’s objectives.

Our Zero Coupon Bond Ladder

You can also create a bond ladder out of zero coupon bonds. Zeros are issued by corporations, the federal government or municipalities at a deep discount from their face value. At maturity, you receive all interest that has accrued since your purchase date, plus the principal.

**Zeros and Taxes**

With corporate or government zeros (taxable zeros), taxes are due annually on interest earned even though you don’t actually receive regular interest income. For retirement planning, taxable zeros are best in an IRA, where your earnings grow tax-exempt, until withdrawn. Outside of an IRA, you should consider tax-exempt zero coupon municipal bonds for a long-term financial goal such as retirement or college planning.

**WORKING TOGETHER WITH PIPER JAFFRAY**

The Piper Jaffray Bond Ladder Service adds value to your portfolio. While the concept of a bond ladder is simple, implementing this strategy often is not. There are many factors to consider when building your bond ladder.

We’ll begin by reviewing our broad inventory and select investments that match your objectives. We offer a comprehensive selection of U.S. government, corporate and municipal bonds. If you invest in CDs, we carry a variety of yields and maturities from financial institutions across the country. All of our CDs are federally insured up to $100,000 per depositor, per institution. Investment alternatives to CDs may not be federally insured and will involve greater risk to principal.

We will provide a written bond ladder proposal tailored to your goals. It’s as simple as talking to your financial advisor about your investment objectives—including your requirements for income, time horizon, and the amount you have to invest.

Preserving wealth … maximizing income … planning for the future. Let your Piper Jaffray financial advisor show you the possibilities.

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