

Bond Ladders

Take the guesswork out of interest rates

When investing in the fixed income markets, future interest rates are an important factor to consider, however, they are almost impossible to predict. Utilizing a portfolio strategy known as “bond laddering” an investor can position their portfolio to take advantage of rising interest rates and ease the effect of lower interest rates.

		Year 1	Future portfolios			
Initial Ladder	1yr Security	3.45%	Year 2			
	2yr Security	3.50%	3.50%	Year 3		
	3yr Security	3.55%	3.55%	3.55%	Year 4	
	4yr Security	3.60%	3.60%	3.60%	3.60%	Year 5
	5yr Security	3.65%	3.65%	3.65%	3.65%	3.65%
Hypothetical	5yr Security		3.65%	3.65%	3.65%	3.65%
	Reinvestment			3.75%	3.75%	3.75%
Rates	5yr Security				3.50%	3.50%
						3.55%
Blended return		3.55%	3.59%	3.64%	3.63%	3.62%

What is a Bond Ladder?

A bond ladder is a portfolio of bonds with staggered maturities. The main objective in “laddering” is to create a system where a portion of the portfolio is available for reinvestment at regular intervals. With maturing amounts coming due at scheduled times, an investor can take advantage of any increase in interest rates by reinvesting these amounts at the higher rate. Should interest rates fall; the investor can mitigate the drop in their returns by having the remaining amounts still invested at higher rates.

Shown on the right is a hypothetical five-year ladder consisting of fixed income securities. A ladder can consist of any combination of corporate bonds, U.S. Agency and/or Treasury securities, municipal bonds, or Certificates of

Deposits. The key component when building an investment ladder is to have securities mature in one-year increments. This schedule of maturities allows the investor to ladder across the investment horizon (the Initial Ladder).

Yields shown are for illustrative purposes only and do not reflect current or future market conditions

To maintain the ladder on an ongoing basis, the investor purchases a new five-year fixed income security to replace the maturing bond, thus keeping the maturities staggered in the portfolio. As demonstrated in the sample ladder, when continuing to reinvest in this vehicle, investors obtain numerous benefits: interest rate diversification (no concentration in a single maturity), a short average maturity, and a higher blended return (the Reinvestment Ladder).

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Benefits of Bond Ladders

Ladders take the guesswork out of interest rate swings

A ladder has bonds maturing at regular intervals. When a bond matures, if interest rates are higher, the new bond added to the ladder takes advantage of higher yields, thereby increasing the overall yield of the portfolio. If rates are lower, the remaining bonds in the portfolio earn a higher yield than is currently available in the market. The net result is a “smoothed out” yield on the portfolio over time.

Ladders provide interest rewards

Fixed income ladders provide predictable interest income and can be structured to provide monthly or quarterly payments. Rather than spend these payments, investors may choose to reinvest the interest payments from the portfolio in the purchase of the replacement bond, thus compounding their investment returns.

Ladders help increase yields and reduce risk

When maintaining a ladder, monies are reinvested into the longer end of the ladder. This is advantageous to investors because typically, as maturities lengthen, yields increase. Staggered maturities also lessen the duration of the portfolio as the average life of the ladder is approximately half as long as the longest maturity.

Bond ladders take the “guesswork” out of interest rates. By providing some protection from interest rate fluctuations, laddering lessens the risks of fixed income investing. Ladders are also a wise diversification strategy for bond investors.