Bonds versus Bond Funds

Most investors don't have the time, resources, or the expertise to build their own portfolio of fixed income investments. This job is best left to investment professionals – portfolio managers of bond mutual funds.

What the investor gets for their MER (Management Expense Ratio)

Liquidity

Bonds are difficult for individual investors to buy and sell. Bond fund managers have much greater access to the bond market, and this provides investors with greater flexibility to buy and sell units of their bond fund whenever they need to.

In addition, coupons received within the fund are reinvested and keep growing for investors. The same can also be said for bond maturities.

All-in-all, bond funds are more convenient for investors than trying to manage a bond portfolio with many individual holdings.

Diversification

As with equities, investors require proper diversification of the bond component of their portfolio. A bond fund invests in many different securities to give investors an optimal mix:

- Term — short (1 to 5 years), mid (5 to 10 years) and long bonds (over 30 years);
- Sector (federal, provincial, corporate);
- Credit rating (AAA, AA, A, BBB); and
- Currency (AIC Global Bond Fund only)

This diversification is captured instantaneously when investors enter a bond fund. To complete this task on their own through buying individual bonds could take months to achieve proper diversification.

Management expertise

With a bond fund, investors get an experienced portfolio management team working for them. This knowledgeable and highly qualified team sets and adjusts term and duration, as required, and reviews and monitors the credit quality of the portfolio. This ensures the maximum potential income and capital appreciation of the investor's fund.

Competitive pricing

With a bond fund, the fund's portfolio manager has well-established relationships with several bond dealers. This enables managers to shop the market for the best price, which helps to ensure a better return for you. An individual investor would have great difficulty doing this on their own, as they normally would be dealing with one bond dealer and must accept the dealer's price.

Portfolio Management

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Wholesale pricing

In the bond market, size does matter. An individual investor doesn't have the same purchasing power as a bond fund manager. Portfolio managers make large transactions everyday to ensure investors get the optimal performance return from their fund. As a result, they're in a position to obtain better pricing for their purchases, which translates into better returns for investors.

Access to inventory

Unlike the stock market, the bond market is an "over-the-counter" market that is dependent on individual bond dealers' inventories. That is to say each bond dealer offers many types of bonds for sale, or perhaps would like to add to their inventory.

Since bond fund managers deal with several dealers, they have access to these inventories. This allows the portfolio manager to search diligently for bond issues, look for better deals, and also make a decision whether the bond dealer could make a market in a particular issue. Individual investors, on the other hand, are usually limited to one dealer and available the inventory. Portfolio managers have greater choice.

Access to new issues

When new bond issues come to market, it's the institutional bond portfolio managers (mutual fund companies, insurance companies and pension funds) that have the "first shot" at orders. The individual or retail investor typically doesn't have an opportunity to purchase a new issue until after the initial announcement. This gives bond fund investors an upper hand over individual investors since the portfolio manager has an opportunity to secure a cheaper price, providing greater return potential.

Summary

Although there are investors who can handle their own bond portfolio of individual securities, there is a case for the ease and efficiency of a bond fund. When you add all of these points together, we believe individual investors receive good value for their bond fund fees.

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