QUICK TAKE ON FIXED INCOME

Q: WHAT ARE THE BENEFITS OF BUYING HIGHER COUPON BONDS?

A: A higher coupon or "premium" bond has a higher coupon rate than the current market interest rate and will trade above par. These bonds sell for more than 100 percent of their par value, so the dollar value is greater than the normal $1,000. These are the reasons we generally recommend higher coupon bonds for our clients:

- They reduce duration risk and market volatility. All else being equal, if interest rates rise, bond prices will fall and vice versa. The longer a bond's duration, the more sensitive it is to rate changes. Premium bonds, however, help guard against possible rate increases and price decreases. The higher coupon provides a cushion against price declines because the price has further to fall before it becomes a discount bond. Premium bond prices tend to change less compared with bonds of similar maturities, reducing the price sensitivity of the fixed income portfolio. For an example, let's look at two New York City municipal bonds:

BOND	MATURITY	YIELD	COUPON	PRICE	DURATION
Bond 1	Aug. 1, 2023	2.80 %	3%	101.632	8.07
Bond 2	Aug. 1, 2023	2.80 %	5%	117.974	7.58

- When interest rates are rising, higher coupon bonds generate more coupon cash flow than lower coupon bonds. This means investors can reinvest more in bonds that will pay even higher yields.

- They can help avoid onerous tax implications. The term de minimis essentially states that investors must pay capital gains taxes for any bond bought at a discount to face value (original issue discount excluded) in excess of a quarter point per year to maturity. This can significantly reduce the bond's after-tax yield. This concern also exists in low coupon bonds that aren't subject to this tax at time of purchase. If the owner wants to sell the bond and rates are higher at the time of sale, the market will treat the bond as de minimis, and the client's bid price will be significantly lower than for the same bond with a higher coupon not in de minimis territory. Many investors are unaware of this situation, but we take strong measures to avoid it.

- Their availability is often better. Most trust companies have strict buying parameters that limit what they can buy, with prices ranging between $98 and $102. Also, many retail brokers put their clients in these same types of par-priced bonds. These two types of buyers help create a strong market demand for low coupon/low dollar bonds. It's Economics 101: A strong demand for a limited product means costs will go up (and yields will go down). With higher coupon bonds, investors can pick up incremental yield over similar bonds with lower coupons, while getting access to the largest number of issuers.

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