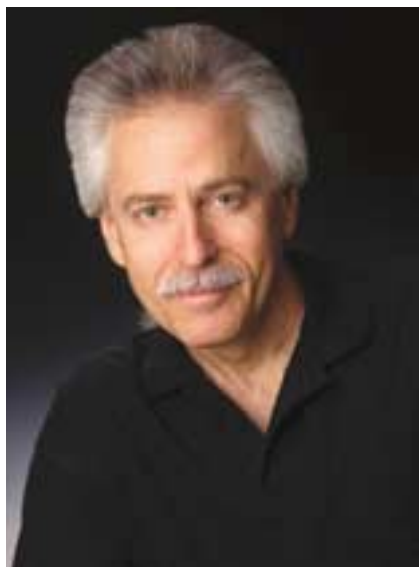


BY DAVID J. DRUCKER

Giving Your Clients a Fixed-Income Advantage

With less-than-transparent transaction costs, how can you be sure your clients are getting a fair deal on individual bonds?



Of municipal bond trades, Dan Roe, a principal with Budros, Ruhlin & Roe, in Columbus, Ohio, says, “Investors and advisors can easily suffer more abuse trading in this market than in the stock market.” Roe refers, of course, to the sometimes embarrassingly greedy spreads that occur on individual bond trades.

Bond spreads are somewhat of a good-news/bad-news story. The good news is that they’re almost impossible for the average client to calculate, so he doesn’t really know whether you’re buying and selling his bonds at prices

that represent a reasonable commission. The bad news is that if you’re not taking the extra steps to ensure reasonable spreads on your clients’ bonds, you’re doing them a disservice.

Some advisors choose to side-step the problem entirely by sticking to mutual funds. Says John Rice of Keats, Connelly and Associates in Phoenix, “We believe that bond funds offer the most effective fixed-income exposure for our clients. We are able to take advantage of the economies of scale that large fixed-income portfolios at Vanguard or PIMCO or DFA have, and this trims the spreads.”

But many advisors nonetheless want individual bonds for their obvious advantages — controllable maturities, laddering opportunities and quality control, to name a few — making individual securities worth the extra effort. How much effort that will be depends upon your awareness of and comfort with the many Internet resources available to help you select bonds frugally and, as always, upon whom you know in the bond market.

One strategy is to stick to the route recommended by your broker-dealer. Bud Kasper, a top producer with Securities America whose RIA is Financial Security Investment

Advisors in Lees Summit, Mo., says, “We use Fixed Income Securities, a San Antonio-based company selected by Securities America, as our single provider of bonds.” In other words, Kasper relies on his broker-dealer’s ability to select a good bond house for him to do business with. However, he adds, “If you asked, ‘Do I know for sure whether or not I’m getting the absolute best execution,’ my answer would be ‘I don’t have any way of knowing.’”

But he does employ a bond transaction policy that benefits his clients: “Because ours is an independent, fee-based firm, we don’t have any commissions associated with our bond trades. I simply tell Fixed Income Securities to back out any commissions associated with the bid or offer. They readily comply because they are simply executing the trade and have no interest in whether or not I want to work with or without getting paid through the trade. I have found it very pleasing when I’m able to secure bonds for clients that are offered at par, and they end up paying below par because the trade was commission-free.”

Sharon Luker, with Wachovia, takes a similar approach but does a double-check before pulling the

switch. "First, I look for a good bond that meets my client's need, and then I go out and try to find the best price. I've found that using my broker-dealer's clearing firm's bond inventory has gotten me the best deals." Wachovia clears through First Clearing of Richmond, Va.

Luker, based in Plano, Texas, goes online to services like BondTrac (www.bondtrac.com), and makes calls to bond houses like LaSalle (www.lasallebonds.com) and First Southwest (www.firstsw.com) to find bonds suitable for her clients. BondTrac provides full disclosure of broker-dealer offerings in municipal, corporate, agency, CMO, Treasury and CD markets. Luker uses LaSalle for CMOs and callable CDs, and First Southwest for Texas municipal bond issues. "Once I find a bond I like, I then have my trade desk go look for it," adds Luker.

Apparently, Internet bond services are helpful to many advisors in the search for client-worthy bonds. Doug Heimforth with Heimforth Wealth Management in Los Altos, Calif., uses two Web-based bond services to identify bonds: www.tradebonds.com and www.bondsonline.com. However, like Luker, he rarely buys his bonds over the Internet. "I've never found a reason to trade online since I can almost always beat the price quotes I find there through the live trading desks." Heimforth has his own independent RIA, and his bond desks are at TD Waterhouse and the independent Wall Street bond firm, Stoever Glass & Co. (www.stoeverglass.com). However, you can employ the same strategy regardless of where your trading desk is located.

Abacus Planning Group in Columbia, S.C., purchases bonds through a variety of sources but also uses a website in its quest for narrower spreads. Says Abacus' Alex Chastain, "We use www.investinginbonds.com to track bond price and yield, obtain history on specific bonds, and look at spreads. This site provides a wealth of information to confirm whether you are receiving a fair price on your trade." Abacus also purchases bonds in large lots and allocates them among many

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— Dan Roe, *Budros, Ruhlín & Roe*

client accounts, thereby leveraging its research efforts once its personnel have found the right bonds at the right price.

As a final strategy, and in tune with the message of industry consultants fond of saying advisors should spend their time only on those things that they do best, Richard Robb outsources his bond trading. A Commonwealth Financial Network rep with his own RIA — Capital Management Partners of Peabody, Mass. — Robb says, "It's almost incumbent on us to not be doing this ourselves and to be using private managers — or a fund for smaller accounts — to add value for the

client, including best pricing. Muni bonds, especially, are getting more complicated [to trade] due to a lack of transparency and the fact that they are largely owned by individual investors without the benefit of a central exchange."

Robb has concluded his time is best spent advising, not watching the bond market, so he uses Breckinridge Capital Advisors, a Boston-based private bond manager for his clients' tax-free bonds. "They have a low charge — 25 basis points — and they help with selection," he explains. Dealing with Breckinridge has allowed Robb to avoid some real turkeys, too, such as private activity bonds guaranteed by K-Mart, certain nationwide airlines, and other companies in financial straits. "Breckinridge is simply able to spend more time finding out these facts than I am," he says.

So it would seem that bond trading, like all activities we engage in for clients, poses a dilemma: Do we use a bond fund or outside trader on the assumption that we can't add discernable value by selecting individual bonds ourselves? Or, do we take on the job of selection and promote to our clients the advantages to them of our efforts, hoping they'll see it as value added? That's your call but, if you do go it alone, be smart about it: Rely on a reputable bond dealer and, at least occasionally, verify the spreads on the bonds he shows you with the specialized Internet tools we've shown you. **IR**

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