JB INVESTMENT MANAGEMENT, LLC

Separately Managed Bond Portfolios versus Bond Funds

Differentiating whether separately managed bond portfolios or bond funds are best suited for a fixed income investor is a simple process. Reviewing several considerations can lead to a logical conclusion.

	Separately Managed Portfolio	Bond Fund
Management	Professionally Managed – Portfolio Managers are accessible	Professionally Managed – Portfolio Managers are not usually accessible
Style	Customized approach to meet specific investor guidelines	Prospectus governs fund guidelines and parameters
Maturity/Duration	Targeted to meet specific investor guidelines or a specified benchmark	Subject to ranges specified within the parameters of the prospectus
Income	Predictable cash flows	Fluctuating monthly income distributions
Price Risk	If held to maturity, individual bonds not subject to unexpected price risk	Redemptions of shares may result in a realized capital gain or loss for all investors
Liquidity	Effectively managed based on client requirements	Daily liquidity based on daily NAV
Diversification	Efficiently diversified with portfolio values in excess of $1 million	Diversification can be established at lower portfolio values
Credit Risk	Customized to meet specific investor guidelines	Dependant on the prospectus and management style
Fees	Management fees are competitive with fund expense ratios, in many cases lower	Explicit (disclosed) and Implicit (not disclosed) fees
Turnover	Low, transactions limited to reinvesting cash flows and properly managing risk attributes	Depends on the manager, see prospectus for turnover. More turnover leads to higher implicit costs

The desire for customization and portfolio size are driving factors in the decision process. Institutional and high net worth investors often have specific constraints and circumstances that require professionally managed individual bond portfolios. Investors with smaller portfolios, non-specific portfolio constraints, and non-specific income requirements may be best suited for a fund.

Additional consideration should be taken by bond fund investors in a rising yield environment. They are exposed to a higher degree of capital loss potential. Clearly, the market value of fixed income instruments decline as yields rise. Individual bonds holders are more immune to rising yields, as they can simply hold an individual bond to maturity. Although the price of a bond may fluctuate, it will earn the yield to maturity from the original investment date and mature at par value. Bond funds have no final fixed maturity date; they only have an average maturity of the underlying collateral.

As yields rise, bond fund holders in general have the propensity to redeem shares to avoid market value declines. Heavy redemptions can force fund managers to sell portions of the underlying collateral and realize losses to raise cash for distribution. In turn, remaining share holders that are not predisposed to sell are subjected to these realized losses. These capital losses may not be recaptured. Alternatively, individual bond holders are only subject to potential capital losses if there is a requirement to sell a position. Portfolio managers in this instance can minimize any adverse consequence and maximize tax effectiveness.