



# MAKING THE SWITCH

Bond Funds vs. Bond SMAs



A diversified portfolio utilizes different sectors and asset classes to help meet an overall financial objective. At Crossmark, our clients allocate their funds to our fixed income products for three reasons: 1) the ability to diversify by economic sector, 2) the ability to invest in what we call a “known entity” to match the client’s specific future cash outflows with future cash inflows from a portfolio of bonds, and 3) the consistent defined income (known as a bond’s coupon) due from a bond issuer’s obligation to make payments in specific amounts on specific dates. Although the diversification component can be delivered via different fixed income options, including mutual funds, the ability to tailor the income stream derived from the portfolio can only be realized through the use of separately managed accounts.

In a separately managed account (SMA), the client does not own a portion of a larger, comingled portfolio of bonds along with other investors, as is the case in a mutual fund. Rather, the client personally owns the individual bonds held in his or her account.

There are many advantages to an SMA providing the ability to tailor your investments to your own personal story in order to help you achieve specific financial goals. An investor may choose a portfolio that matches their liabilities with specific maturity requirements, helping to negate the need for selling shares of a mutual fund at perhaps an inopportune time in the market.

Fixed income total return is comprised of two factors – a price return and an income return. As interest rates and/or credit spreads shift, the price return could be negative. Unfortunately, it is at this time that many fixed income mutual fund shareholders decide to liquidate causing the fund to capture losses. If an investor owns individual bonds, he or she can make the choice to hold a bond to maturity, thereby decreasing the effects of market value volatility and allowing the investor to collect the yield to maturity contemplated at the date of purchase.

For clients who rely on a specific income stream, the advantage of investing through an SMA is once again apparent. Since the investor owns the individual bonds, as income is paid, he or she can simply withdraw those funds from the account and use that income for whatever purpose, as needed, such as school tuition, healthcare, living expenses, or other family obligations. This income flow is a contractual obligation from the bond issuer to pay, in most cases, a consistent amount of interest every six months.

### Simplified example of coupon and principal payments under a Bond SMA

Months	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	
Bond A						A						A				Coupon
												A				Principal
Bond B	B						B						B			Coupon
													B			Principal
Bond C		C						C						C		Coupon
														C		Principal

Client decides whether coupon/maturity payments are re-invested or distributed as cash.

Bond SMA	B	C				A	B	C				A	B	C		Coupon
												A	B	C		Principal

With a mutual fund, the investor doesn't have the ability to receive those same coupon payments on each payment date nor does the investor have a say in whether to withdraw the funds or reinvest them back in the portfolio – this decision is at the discretion of the fund's portfolio manager. Having the ability to make such decisions for one's self is important to many fixed income investors.

### Simplified example of coupon and principal payments under a Bond Mutual Fund

Months	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	
Bond A						A						A				Coupon
												A				Principal
Bond B	B						B						B			Coupon
													B			Principal
Bond C		C						C						C		Coupon
														C		Principal

Fund manager distributes portion of coupon/maturity payments as monthly or quarterly cash dividends, re-invests remainder in new bonds.

Bond Mutual Fund			Div			Div						Div				Div	Dividends

Source: Crossmark Global Investments

There are an infinite number of ways to structure an investment portfolio based on a client's individual financial goals. For clients who are looking for diversification, the ability to match their liabilities with maturing bonds to reduce the need to liquidate, the power to determine how to utilize their own earned income, and the advantage of having their own personalized investment experience, a separately managed account is worth considering as an appropriate fixed income investment option.

## About Crossmark's 30 Year History

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