

Finra bond warning a real worrier

Regulator's caution speaks volumes about bleak prospects for debt investors

By Dan Jamieson

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Finra may be late to the party, but its warning to investors about the risks in bonds is still timely, advisers said.

The Financial Industry Regulatory Authority Inc. told investors in an alert Thursday that in the event of rising interest rates, "outstanding bonds, particularly those with a low interest rate and high duration, may experience significant price drops."

Big investors ranging from Bill Gross, co-founder of Pacific Investment Management Company LLC and manager of the world's largest bond fund, to Jim Rogers, chairman of Rogers Holdings, as well as The Goldman Sachs Group Inc., already have warned that risk in the bond market is rising.

But last month's small move in interest rates made Finra's warning more resonant.

"I think it's probably timely," Pete Bush, co-founder of Horizon Wealth Management LLC, said, referring to Finra's alert. "We've been talking about [the risks] for a while, and we're seeing an uptick [in rates] and a negative return on Treasuries in January. I don't know if this is the beginning of a big move or not," Mr. Bush said, but investors need to be warned.

According to the alert, posted on Finra's website, a bond fund with a 10-year duration will decrease in value by 10% if rates rise 1 percentage point.


Mr. Bush said he often meets investors who don't realize they can lose money in what they think are safe bond funds.

"We see it all the time," agrees John Nowicki, president LCM Capital Management Inc. "We see bond funds with 5% yields and go through the holdings and see this awesome 'other' category" of odd-ball holdings that are difficult to evaluate.

Mr. Nowicki thinks the Finra warning is helpful but he said the regulator could be more aggressive about warning investors off risky, complex products.

Finra urged bond fund investors to check on the duration in the product's fact sheet, and said individual bond investors can check with their investment professional, the bond's issuer or use an online calculator to get the figure.

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The Finra alert points out that not even short-duration bonds are free of risk.

“Bonds and bond funds are subject to inflation risk, call risk, default risk and other risk factors,” the warning said.



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