Choosing the right option in the stock and bond market

Choosing the right mix of stocks and bonds can be one of the most basic yet confusing decisions facing any investor. In general, the role of stocks is to provide long-term growth potential and the role of bonds is to provide an income stream. The question is how these qualities fit into your investment strategy. When an investor buys shares of stock, he or she buys part ownership in a corporation. As such, the value of that corporation's stock will tend to reflect the earnings experience of the firm. Generally speaking, the higher the potential return, the higher the risk. For example, stock investors expect a fairly high rate of return because there is no schedule of repayment and no stated rate of return like that paid by fixed-income securities such as bonds.

Meanwhile Bonds represent loans made by investors to companies and government. A bondholder, in effect, holds an IOU. Bondholders do not share in a company's profits. Rather, they receive a fixed return on their investment. This return, stated as an interest rate on the bond, is called the "coupon rate" and is a percentage of the bond's original offering price. Bonds are issued for specified time periods. When the bond expires and the principal (original investment) is returned, the bond is said to have matured. Every bond carries the risk that a promised payment will not be made in full or on time. As uncertainty of repayment rises, investors demand higher levels of return in exchange for assuming greater risk. Bonds, similar to common stocks, fluctuate in market value and, if sold prior to maturity, may produce a gain or a loss in principal value.

How should investors choose the right option? An important distinction when weighing the rewards of stocks vs. bonds is that stocks have (theoretically) an unlimited ability for appreciation. That is, there is no upper limit to how valuable they can become. On the other hand, a bond buyer generally knows the upper limit to expect on such an investment, especially if it is held to maturity. It is true that a bond can sell at a premium prior to maturity, but the potential for appreciation here is nowhere near as great as it is for stocks. Both options have their risks as well. With stocks, although theoretically there may be no ceiling, there is a bottom. Stocks can drop in value and become worthless. With bonds, there is interest rate, inflation and credit risk. Credit risk is the risk that the bond issuer will be unable to make its payments on time or at all, effectively defaulting on the bonds.

Diversifying your investment funds among various classes of stocks and bonds is the choice for many. A mix of stable, fixed-income investments (to help cushion stock market volatility) and stocks (to provide growth potential over the long-term) is a key ingredient to working toward meeting long-term financial goals**.** Mutual fund objectives, risks, charges, and expenses should be carefully considered before investing in the fund. Bond investors should carefully consider risks such as interest rate risk, credit risk. Please remember that all investments carry some level of risk, including the potential loss of principal invested. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns. Although stocks have historically outperformed bonds, they also have historically been more volatile. Investors should carefully consider their ability to invest during volatile periods in the market. Diversification and strategic asset allocation do not assure profit or protect against loss in bearish or declining market.

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