Please note: This is an AI generated transcription - there may be slight grammatical errors, spelling errors and/or misinterpretation of words.

What Are Bonds?

Rashad Sullivan: What is a bond? Think of it like an IOU. When you purchase a bond, you're lending money to the government, a private company or your local community. In return, they promise to pay you back later with a little extra in exchange for borrowing your money. The amount a bond pays you in return is called the yield.

Now, you can buy bonds directly through a broker or indirectly by investing in investment funds that contain them. If you have an employer sponsored retirement account, you may have access to a bond fund that contains multiple types of bonds. Here are a few types of bonds you should know about.

First, government bonds. These are a way of lending your money to the federal government. They're usually a relatively low risk investment choice because the government tends to pay back what it owes next, or corporate bonds. These are loans to private companies. Since they can be riskier and can't guarantee future stability, corporate bonds often pay a higher yield.

In return for higher risk. There are also municipal bonds that are sometimes called muni bonds. These come from local governments like states or cities. One benefit of muni bonds is that typically the interest earned is not taxed, meaning you could potentially see a higher return on muni bond than for a corporate bond.

This is because for corporate bonds. The interest you earn will usually be taxed. Why would you want to buy bonds? The most common answer is that they tend to be less volatile than stocks and have a steadier growth pattern over time. This makes them a potentially good way to balance riskier investments in a diversified portfolio.

But like stocks, bonds still involve risk. Their terms can be cut short. If interest rates fall, the issuer could default on its financial obligations or a number of other unlikely but possible scenarios. The truth is bonds play many different roles in individual investor portfolios. The role they play in your portfolio depends on your personal financial picture.