

Opinion/Editorial

You may want to consider municipal bonds and Build America Bonds

Tax season “officially” ended on April 15. Yet you can explore tax-smart investment opportunities all year round. And when you’re looking at the fixed income side of your portfolio, you may want to consider two possibilities: municipal bonds and Build America Bonds.

You’ve probably heard of municipal bonds, but you may not be familiar with how they work. You can find two key types of municipal bonds: General obligation bonds finance the daily operations of a municipality or school district, while revenue bonds finance hospitals, utilities, airports, affordable housing and other public works. So when you purchase a “muni,” you are helping support a community. Of course, your investment will bring you some tangible benefits, too. First, you’ll receive regular interest payments. Furthermore, these payments typically are exempt from federal income taxes — and possibly state and local income taxes, too. If you’re in an upper income bracket, you may find munis to be especially valuable. (Keep in mind, though, that some “private activity bonds,” which are typically used to finance airports, housing or stadiums that can benefit private entities, may be subject to the alternative minimum tax, or AMT.)

Build America Bonds (BABs) share some sim-



Financial Focus

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ilarities with tax-free municipal bonds, although BABs are taxable investments. BABs provide capital to municipalities so that they can build or improve infrastructure, including schools, roads, public buildings and so on. The U.S. Treasury pays state or local government issuers a subsidy equal to 35% of the interest they pay investors for buying the bonds.

BABs have proved quite popular among institutional investors, such as pension funds, that typically don’t benefit from tax-free municipal bonds. But are they right for you? It all depends on your individual situation.

If you owned a BAB, your interest payments would be federally taxable, but you might get some state tax breaks if you live in the state where the bond is issued.

Many BABs have long-term maturities, which may not be a problem if you’re buying the bond for its steady interest payments and plan to hold it for its entire life. But if you think you might want to sell your bond before it matures, be aware that longer-term bonds, by their very nature, are subject to greater interest rate risk than short-term bonds — that is, longer-term bond prices will be more affected by interest rate movements.

Furthermore, you’ll have to consider credit risk — the possibility that the issuer of your bond will default or be unable to make payments. Remember, the municipality issuing the bond, not the federal government, backs a BAB. Although past performance is not a guarantee of future results, municipal bonds’ historical default rates have been low.

Ultimately, you’ll need to consult with your tax advisor before purchasing either a municipal bond or a BAB. Like all investments, they can provide you with benefits, but you need to be absolutely sure of what you’re getting.

Submitted by Lori Fell, Edward Jones Financial Advisor. Lori will be opening an office in Leslie Spring 2010 and is currently working out of the Mason office. Call Lori at (517) 392-5320.

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