'Duration' Is a Key to Bond Funds' Risk

WSJ
5 '96
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YOUR MONEY MATTERS

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Thinking about bailing out of your bond fund? Or maybe you are bargain hunting, looking to dive into some fund that has been beaten up in the recent bond-market debacle?

Don't do anything until you have checked the "duration."

Duration is one of those financial-markets terms that makes many people's eyes glaze over. But you don't have to be a rocket scientist to use duration as a tool in judging the risk in bond funds.

"It's an important way to help investors realize how volatile their bond fund is," says John Rekenthaler, editor of Morningstar Mutual Funds Inc., a Chicago publication that tracks mutual-fund performance.

Technically speaking, duration is one measure of a bond's life. It's a mathematical calculation of how long a bond must be held to realize the stated yield, assuming it was bought at face value, no matter what th[illegible] [illegible]arket does.

[illegible]e important for the average investor, however, duration measures a bond fund's sensitivity to interest-rate increases and declines, and can provide an early warning of dangers ahead.

How Safe Is Your Bond Fund?

Duration is the key to how your bond fund will react to further rises in interest rates. Here's how several corporate high-quality bond funds—with different durations—have reacted to the latest rise in interest rates.

FUND NAME	TYPE	TOTAL RETURN MARCH 28-APRIL 4, 1994	DURATION AS OF MARCH 31, 1994
Security Income Corporate Bond	Long	−3.4%	6.5 years
IAI Bond	Long	−3.0	6.5 years
IDS Selective	Intermediate	−2.8	6.4 years
Fidelity Intermediate	Intermediate	−1.4	3.1 years
Intermediate Bond Fund of America	Intermediate	−1.5	4.0 years*
IAI Reserve	Short-term	+0.1	0.2 years

*As of Feb. 28
Source: Morningstar Mutual Funds and individual funds

Most investors realize that bond-fund prices fall when interest rates rise, and rise when interest rates fall. And many investors know that long-term bond funds are more sensitive to a given interest-rate move than short-term bond funds. Duration allows an investor to quantify the likely price move.

To get a rough idea of the impact that future interest-rate changes will have on a bond fund, you merely multiply the fund's duration by the rise or fall in interest rates.

For example, **Security Income Corporate Bond** Fund had a duration of 6.5 years as of the end of the first quarter. If interest rates rise one percentage point, Security Income Corporate Bond will lose about 6.5% in principal, says Jane Tedder, the bond fund's manager. If rates fall one point, it should gain about 6.5%.

If you think interest rates will continue to rise, the shorter the duration of your bond fund the better, says Jennifer Newport, bond-fund analyst for Morningstar. When interest rates are headed downward as they were for the past decade, the longer the duration, the better for investors.

Although duration is worked out with a

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'Duration' May Be a Key Word As Investors Check Bond Funds

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complicated mathematical formula, you don't need to whip out your calculator and plug in the payment schedule and maturity date of every bond in your mutual fund to come up with the answer. Many mutual-fund families will tell you the duration of their bond funds if you call their toll-free numbers and ask a fund representative.

It's important to note that duration numbers are a "rough estimate" of what will happen, since the numbers for each fund change daily, Mr. Rekenthaler says. Currently, many bond funds are shortenir[illegible] [illegible]eir durations by selling longer-term b[illegible] and buying shorter-term bonds to protect against rising interest rates.

Morningstar has begun to publish the duration figure in its biweekly reports on corporate-general bond funds, corporate-high-quality bond funds and government funds, says Mr. Rekenthaler. It plans in the near future to publish duration figures for the bond portions of hybrid funds—balanced funds and asset-allocation funds that invest in both bonds and stocks.

The company doesn't yet have duration figures for municipal and international bond funds because the numbers are more difficult to get, he says.

Duration is a sharper measure of volatility than using a bond fund's average maturity, pros say. That's because it takes into account that investors are steadily recouping their investment each time they receive an interest payment or any interim principal payment, says Steven Norwitz, vice president of T. Rowe Price mutual fund group. Average maturity doesn't do that.

If using duration sounds like too much trouble, think again. "People are becoming much more concerned about the safety of their bond portfolios now," says William John Mikus, partner in Financial Design, a Los Angeles investment advisory firm. "They have to redouble their efforts to understand what they own and what they are buying."

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