# $25 par bonds:

## "Baby bonds" with potential growing pains

Brian Therien, CFA • Senior Fixed-Income Analyst

Bonds are typically traded by a network of dealers, but some bonds — called $25 par bonds or "baby bonds" — trade on exchanges just like stocks.

They have smaller denominations, usually an initial investment of $25 instead of the $1,000 or $5,000 of traditional bonds. Some investors confuse $25 par bonds with preferred stocks and common stocks. But $25 par bonds are debt instruments with the same features of corporate bonds and should be viewed similarly.

Be sure to consider the similarities and differences between baby bonds and traditional corporate bonds before deciding whether baby bonds are appropriate for your portfolio.

### $25 par bonds vs. traditional corporate bonds

| Similarities | Differences |
|---|---|
| • Sensitivity to interest rates<br>• Maturity date<br>• May be callable<br>• Can default on principal and interest payments | • Are traded on an exchange<br>• Have a smaller par or face value amount, typically $25 |

## Be wary of:

### Limited liquidity

Liquidity refers to how frequently and easily a security is traded. As an investor, you need your investments to be liquid. The more frequently an investment is traded, the better the price you may obtain.

Since baby bonds are traded on an exchange, you will need to consider liquidity. Unfortunately, most baby bonds are far less liquid than other exchange-traded investments, which can present a problem, particularly when selling.

Without sufficient liquidity and few buyers, the price may be lower than you expected. And liquidity problems can be magnified during times of market turmoil, when there are more sellers than buyers. We encourage investors to use limit orders when purchasing or selling $25 par bonds as a way to minimize the impact of limited liquidity. With a limit order, you set the maximum or minimum price at which you buy or sell an investment.

### Poor quality

We generally don't recommend bonds rated below investment grade or not rated at all. We also apply this guideline to par bonds.

### Poor structure

The structures of some baby bonds, such as those with very long maturities, are inappropriate for individual investors. We believe long maturities expose you to more interest rate risk than necessary. We recommend you limit fixed-income investments to maturities of 30 years or less.

Other examples of poor structures are baby bonds that own overly complex investments but are still structured as baby bonds. These complex structures can be difficult to identify, and we believe they present potential risks that aren't appropriate for most individual investors.

## What to look for instead:

### Quality

We believe that, when looking at any bonds, you should focus on investment-grade quality. Higher-quality bonds have far fewer defaults than lower-quality bonds, and $25 par bonds are no exception.

### Ample liquidity

If you are going to invest in baby bonds, we recommend you make sure the bond issue is relatively liquid and will provide you the opportunity to sell at a fair price at some point in the future. You may want to consider traditional bonds that can offer more liquidity than baby bonds but have a similar structure.

Bond funds and exchange-traded funds (ETFs) are another potential solution for fixed-income exposure. They offer more liquidity than $25 par bonds.

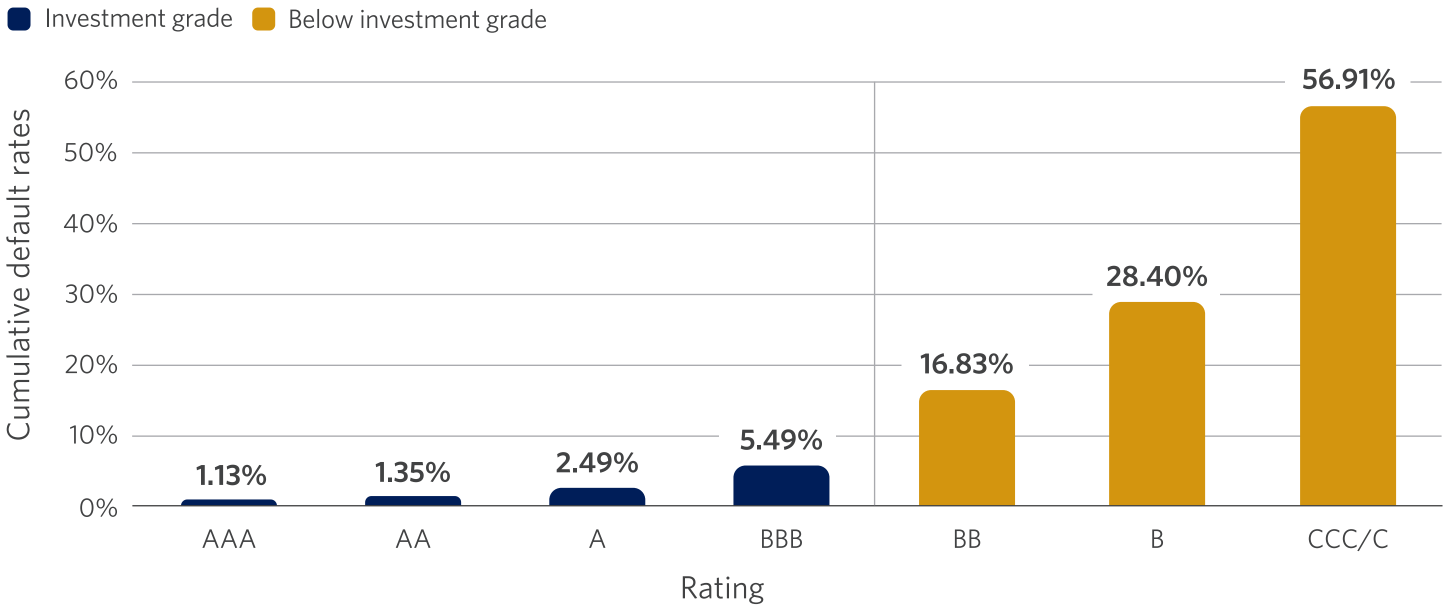
### Less than 30 years' maturity

At Edward Jones, we don't recommend fixed-income investments with maturities greater than 30 years. Some baby bonds have up to 60-year maturities. We believe this additional maturity doesn't benefit individual investors.

## U.S. corporate average cumulative default rates

1981–2022




Source: Standard & Poor's. Time horizon = 15 years.

Past performance is not a guarantee of future results. Diversification does not guarantee a profit or protect against loss in a declining market. Cumulative average default rates are calculated by taking the weighted average of annual default rates in each rating category and accumulating the results across all the years covered by the study. In this way, they take into account any change in an issuer's credit rating over time. Before investing in bonds, you should understand the risks involved, including interest rate risk, credit risk and market risk. The value of a bond will fluctuate, and you may lose some or all of your principal.

## Other fixed-income solutions

In some cases, higher-quality $25 par bonds could make sense as a part of a long-term investor's diversified portfolio. But since they are similar to more traditional bonds, we believe investors should consider traditional bonds or bond funds and ETFs first, as these investments offer more choices that can fit your investment portfolio. Talk to your Edward Jones financial advisor about which fixed-income investments offer the right solution for you.