Do fixed-income UITs make sense for your portfolio?

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Bonds can play an important role in your overall investment portfolio, because they can provide diversification, stability and income. There are a variety of ways to own them, including owning individual bonds directly, mutual funds and exchange-traded funds (ETFs). Fixed-income unit investment trusts (UITs) are another option. To evaluate how UITs fit in your portfolio, it's important to understand their unique features and trade-offs.

What you need to know

- Consider your investing time horizon.
- Understand that unit investment trusts (UITs) are professionally selected but not actively managed.
- Remember that fixed-income UITs can offer a transparent, diversified portfolio of bonds.
- Know the costs of owning UITs and the alternatives.
- Keep in mind, any UIT strategy isn't guaranteed to achieve or maintain its investment objective.

What is a unit investment trust?

Like mutual funds, UITs are portfolios of professionally selected stocks or bonds. However, unlike mutual funds, UITs are fixed, which means once those stocks or bonds are chosen, they typically don't change. Because these securities aren't actively managed, investors have more visibility into what they own. UITs can usually be sold on any business day at the current market price, which may be more or less than the investor initially paid.

Fixed-income UITs are portfolios of bonds selected based on a stated investment strategy. These strategies usually focus on providing predictable monthly income and are typically categorized as either taxable or tax exempt.[1]

Taxable trusts own bonds such as corporate, U.S. government or taxable municipal bonds. Tax-exempt trusts own tax-exempt municipal bonds. The maturities of the bonds held within the portfolio determine the expected life of the trust, with principal returned as the individual bonds mature or are called. Fixed-income UITs with different maturities may help improve the diversification and laddering of your fixed-income portfolio.

Here are some key features of fixed-income UITs:

Income payments:

Fixed-income UITs typically pay monthly income, which can be fairly predictable, since the bonds in the trust do not frequently change. When bonds mature or are called, the result is a return of principal and a decrease in income as remaining bonds in the trust continue to generate income over time.

Termination date:

A fixed-income UIT has a finite life and will return a portion of its principal as the bonds in the trust are called or mature. This is different from bond mutual funds and ETFs, which generally reinvest principal into the fund.

Defined par value:

Fixed-income UITs have a defined par value based on the bond holdings in the trust. The par value is the amount of principal that investors can likely expect to be returned over the remaining life of the trust. This is different from mutual funds and ETFs, which have only a net asset value (NAV) that floats based on daily market price changes.

Fees and expenses:

Fixed-income UIT purchases have an upfront sales charge and ongoing administrative fees. A full breakdown of expenses can be found on UIT fact cards and prospectuses.

Our take on fixed-income UITs

If you don't own individual bonds or would like to complement your individual bonds, we believe fixed-income UITs can be a cost-effective option for obtaining professional bond selection and diversification at a low minimum investment.

While fixed-income UITs are not actively managed, some investors may prefer their transparency, more predictable monthly income and defined par value. We generally recommend only fixed-income UITs focused on investment-grade bonds.

For investors with aggressive income strategies such as non-investment-grade or emerging-markets bonds, we believe bond mutual funds or ETFs are more appropriate than UITs. That's because bond funds and ETFs are generally more diversified, which we believe is very important as the credit environment changes over time.

As with any investment, we recommend thoroughly comparing UITs to all investment alternatives to understand the differences and trade-offs before purchasing, including fees and expenses.

Taxation

It's important to understand the tax considerations of UITs. The termination of a trust is a taxable event, regardless of whether the proceeds are rolled over into a new trust. Interest and dividend payments, returns of principal, and termination of UITs are the most common taxable events to consider. Review the prospectus and consult with a tax professional to understand your personal situation.

UIT fees and expenses may include:

- Sales charges
- Organizational costs
- Annual administrative expenses

Risks

Fixed-income UITs contain bond investments that are subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease. If a bond within a UIT matures or is called, the principal will be returned, subjecting the investor to reinvestment risk. Also, bonds in UITs are subject to credit risk, as prices can fluctuate based on market concerns about financial condition, and the issuer may be unable to pay interest or repay principal. UITs holding fewer securities could have more price volatility than more diversified trusts with a greater number of holdings. Review the prospectus with your financial advisor and discuss the risks associated with the specific UIT strategy you are considering.

Do fixed-income UITs fit in your portfolio?

Fixed-income UITs can complement your individual bonds, mutual funds or ETFs, providing potential diversification and professional selection. In addition, they could be a way to start a smaller portfolio, since they can offer a diversified package of bonds at a low minimum investment and can usually be sold on any business day at the current market price. In general, we think fixed-income UITs may offer exposure to a diversified basket of bonds.

Please review the prospectus to understand the features, risks and benefits of UITs. Talk with your Edward Jones financial advisor about the benefits and differences compared to other investments you're considering.

[1] The income from bonds within a nontaxable bond UIT is generally federal tax-free. However, activity inside the trust portfolio, including liquidations from other unitholders, may cause early returns of principal distributed to the client. Some or all of the trust's income and any principal distributions may be reclassified as taxable income or taxable capital gain distributions. This reclassification will be disclosed on the client's year-end tax documents.

Edward Jones, its employees and financial advisors are not estate planners and cannot provide tax or legal advice. You should consult your estate-planning attorney or qualified tax advisor regarding your situation.

