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Business

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finances and you

Sid Mittra

Pros and cons on zero coupons

A novel way to invest your money is to put it in zero-coupon bonds. The idea behind this kind of investment actually is old, but in recent years it has become extremely popular with investors.

With a conventional bond you clip a coupon and receive an interest payment, typically every six months. "Zeros," on the other hand, eliminate both the coupon and the interest. Instead, they operate like a U.S. Savings Bond: You buy the bond at a substantial discount from its face value, then collect the full value when it matures years later.

The idea sounds simple enough to attract lots of investors, but, there is a catch. Even though you receive no annual interest, the IRS requires that you report it as if you had The difference between what you paid for the bond and what you will receive when it matures is taxable annually on a pro-rated basis.

That rule put a damper on this type of investment until the emergence of the IRAs. You can buy a zero-coupon bond, put it into an IRA and ignore taxes until you actually withdraw the money. Zeros are also an attractive way to give financial gifts to minors, who are likely to be taxed at a low rate.

THE BONDS have proven popular for a couple of other reasons as well. For one thing, you don't have to worry about where to reinvest your interest payments because you don't receive any. For another you don't need a lot of cash to buy a zero-coupon bond. They usually come in denominations as low as $1,000 and are sold at discounts from face value of 50 percent to 75 percent, depending on the maturity.

The Disadvantages. All is not well with zero-coupon bonds, however. One of the main risks associated with zeros is that because they carry a fixed yield, the value of your holdings would decline if interest rates rose. And you wouldn't be receiving any interest payments that you could reinvest at the new, higher rates, as you would with conventional bonds. If rates rise, conventional bonds lose less of their value than zeros. If, on the other hand, you expect rates to fall, you can lock in a fixed return with the zero. A conventional bond serves the same purpsoe, but there is a catch.

Take the case of a 10-year conventional bond and a zero, each paying 15 percent. At a lower rate you would earn less than with the zero.

Suppose the zero were priced instead to yield at 13.5 percent (zeros often carry a lower rate than comparable coupon bonds). It is estimated that you would have to reinvest at between 11 percent and 12 percent to earn a comparable return on a 15 percent conventional bond. If you are deciding between a zero and a traditional bond, your broker can quote you a "break-even" reinvestment rate.

So whether you buy a zero or a conventional bond depends to a great extent on whether you think interest rates will fall and how far.

Spreading the risk. The company issuing your zero-coupon bond could default without having paid you any interest. But there are ways to hedge your bets. A number of brokers have zero-coupon "unit trusts" that invest in'a portfolio of bonds.

Sid Mittra is president of Coordinated Financial Planning Inc. in Troy and a professor of economics and management at Oakland University in Rochester.

datebook

● TAX-FIGHTING INVESTMENTS
Thursday, Feb. 9 — Free seminar "Investments to Fight Taxes & Inflation" begins at 7 p.m. in Rochester. Sponsor: E.F. Hutton. Reservations: Bob Sheppard, 656-0800.

● WOMENS NETWORK
Friday, Feb. 10 — Professional Womens Network meets 7:30-9:30 p.m. in Farmington Hills. Information: 477-8404.

● INSURANCE SEMINAR
Saturday, Feb. 11 — Computer Spreadsheets as a Sales Tool one-day and 1½-day seminars for beginners and advanced in Southfield. Reservations: 557-78767. Sponsor: The Word Pros Inc.

● GMAT PREPARATION WORKSHOP
Saturdays, Feb. 11 to March 10 — GMAT Preparation Workshop from 9 a.m. to 12:30 p.m. in Rochester. Fee: $115. Sponsor: Oakland University. Information: 377-3120.

● GOVERNMENT ACCOUNTANTS
Monday, Feb. 13 — Association of Government Accountants meeting. Information: Yonma Ware, 226-2919.

● RUNNING A SMALL BUSINESS
Monday, Feb. 13 — "How to Run a Successful Small Business," 18-hour, six-meeting course, offered beginning at 7 p.m. in Southfield. Fee: $225. Registration: 557-4665. Sponsor: Wayne State University.

● INTERVIEW TECHNIQUES
Tuesday, Feb. 14 — "Interviewing Techniques: Getting the Best" seminar presented for small business owners 9:30-11:30 a.m. in Detroit. Free afternoon counseling. Registration: $20. Information: 577-4665. Sponsor: Wayne State University.

● STARTING SMALL BUSINESS
Tuesday, Feb. 14 — "How to Start a Successful Small Business," 18-hour, six-meeting course, offered beginning at 7 p.m. in Southfield. Tuition. $225. Registration: 577-4665. Sponsor: Wayne State University.

● JAPANESE MANAGEMENT
Tuesday-Thursday, Feb. 14-16 — "Participatory Management: Techniques from Japan's Best Firms" will be presented in Dearborn. Information: Lisa Springer, 271-1500, Ext. 387. Sponsor: *Society of Manufacturing Engineers.*

● ENROLLED AGENTS
Wednesday, Feb. 15 — National Association of Enrolled Agents meeting. Information: Gino Pallaroli, 977-6950.

● INTERNAL AUDITORS
Wednesday, Feb. 15 — The Institute of Internal Auditors meeting. Reservations: Sherman Parker 557-2128. Deadline: noon Monday.

● SOLE PROPRIETORSHIP
Thursday, Feb. 16 — "Tax Benefits of Sole Proprietorship" seminar presented for small business owners 9:30-11:30 a.m. in Detroit. Free afternoon counseling. Registration: $20. Information: 577-4665. Sponsor: Wayne State University.

● INDUSTRIAL MARKETERS
Thursday, Feb. 16 — Meeting. Information: Allan G. Hall, 649-0070.

● ACCOUNTANTS ASSOCIATION
Thursday, Feb. 16 — National Association of Accountants meeting. Information: Steve Drexel, 362-4444, Ext. 545.

● MATH SKILLS WORKSHOP
Saturday, Feb. 18 — Mathematics skills workshop for students preparing for GMAT, GRE and SAT from 9 a.m. to 4 p.m. in Southfield. Registration: 540-5988. Sponsor: University Testing Service.

● STRESS MANAGEMENT
Tuesday, Feb. 21 — "Stress Management for Health and Wellness" will be presented 8-10 a.m. in Bloomfield Township. Fee: $5 for members, $10 for non-members. Sponsor: Council on Small Enterprises of Oakland County Chamber of Commerce. Reservations: 644-3683.

● WOMEN IN REAL ESTATE
Tuesday, Feb. 21 — Women's Commercial Real Estate Association meeting. Information: Rusty Rosman, 363-1595.

● GROUP TECHNOLOGY
Tuesday-Thursday, Feb. 21-23 — "How to Apply & Implement Group Technology" clinic will be held in Dearborn. Certified Manufacturing Engineers and Technologists attending will earn 18 Professional Recertification Credits from the Manufacturing Engineering Certificiation Institute. Registration fee: $340 for SME members, $490 for non-members. Information: 271-1500. Sponsor: Society of Manufacturing Engineers.

● TAX-FIGHTING INVESTMENTS
Wednesday, Feb. 22 — Free seminar "Investments to Fight Taxes & Inflation" begins at 7 p.m. in Rochester. Sponsor: E.F. Hutton, Reservations: Bob Sheppard, 656-0800.

● GMAT PREPARATION
Wednesday, Feb. 22 — Extended program for Graduate Management Admission Test will be offered in six sessions 6-10 p.m. in Southfield. Registration: 540-5988. Sponsor: University Testing Service.

● INTRO TO COMPUTERS
Wednesdays and Saturdays, Feb. 22 to March 3 — Four-session "Easy Introduction to Computers" course offered in Rochester. Tuition: $70. No background required. Information: 377-3120 during normal business hours. Sponsor: Oakland University.

● INTEGRATING CAD/CAM
Wednesday-Thursday, Feb. 22-23 — "Integrating CAD/CAM into the Organization: The Critical Issues" clinic will be held in Dearborn. Certified Manufacturing Engineers and Technologists attending will earn 18 Professional Recertification Credits from the Manufacturing Engineering Certificiation Institute. Registration fee: $340 for SME members, $490 for non-members. *Information:* 271-1500. Sponsor: Society of Manufacturing Engineers.

● LSAT PREPARATION
Friday, Feb. 24 — Weekend seminar in preparation for Law School Admission Test will be offered in six sessions 6-10 p.m. in Southfield. Registration: 540-5988. Sponsor: University Testing Service.

● INTERNAL AUDITOR EXAM
Saturdays, Feb. 25 to May 5 — Certified Internal Auditor Examination Review offered in the mornings in Rochester. Tuition per class: $30-$45. Information: 377-3120. Sponsor: Oakland University.

● SAE CONGRESS
Monday-Friday, Feb. 27 to March 2 — Society of Automotive Engineers International Congress and Exposition will be held in Cobo Hall in Detroit. Information: Dave Mitchell, 400 Commonwealth Drive, Warrendale, Penn. 15096.

● LOTUS LITERACY
Monday, Feb. 27 to Saturday, March 3 — Two- or four-day course offered mornings and evenings in Troy. Use Lotus 1-2-3 on the IBM PC. Tuition charged. Information: 689-8282. Sponsor: Walsh College of Accountancy and Business Administration.