

Bond Funds Can Add Stability

By PAULETTE MINITER | SMARTMONEY

Desperate measures are often born in desperate times, and today's investing environment is no exception. From mutual funds that let you double-short stocks to exchange-traded funds enticing you to double-long oil, there are plenty of options that promise to make up for underperforming equities. But why reinvent the wheel when good old bonds, a traditional safe haven, can add stability to a portfolio rocked by stock-market volatility?

One of the simplest and cheapest ways to buy bonds is through a mutual fund or ETF that tracks an index of fixed-income securities. This passive approach can help you avoid the pitfalls of actively managed funds, whose managers might be tempted to chase higher yields by buying riskier debt. Not all index funds, however, do a great job tracking their indexes. It is a feat one Morningstar analyst has called "art as well as science," because bond indexes often have thousands of holdings that are difficult to replicate precisely.

We asked Lipper Inc. for help finding the best and cheapest bond-index mutual funds and ETFs available to retail investors based on three-year returns, as well as the worst and most expensive ones. We limited the search to taxable bond funds, ruling out municipal-bond funds, which are best held outside of tax-sheltered accounts. We also cut out funds requiring minimum investments above \$5,000.

The big winners: ETFs from iShares and mutual funds from Vanguard, all of which track fixed-income benchmarks from Lehman Brothers.

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