

# **Explore TIPS**

A practical guide to investing in  
Treasury Inflation-Protected  
Securities

By

The Finance Buff

Copyright © 2010 The Finance Buff

No part of this publication may be reproduced or distributed without express permission of the author.

To Linda



## Contents

<b>Preface .....</b>	<b>ix</b>
<i>Acknowledgement .....</i>	<i>x</i>
<b>Chapter 1 Bonds Refresher .....</b>	<b>1</b>
<i>CDs Are Bonds Too.....</i>	<i>1</i>
<i>Bonds Trade.....</i>	<i>2</i>
<i>Present Value and Yield to Maturity.....</i>	<i>3</i>
<i>Price, Interest Rate, and Duration.....</i>	<i>5</i>
<i>Bond Ladder and Bond Funds .....</i>	<i>8</i>
<i>Bonds and Taxes.....</i>	<i>10</i>
<i>More on Bonds .....</i>	<i>11</i>
<b>Chapter 2 TIPS Basics.....</b>	<b>12</b>
<i>What Are TIPS.....</i>	<i>12</i>
<i>Real vs. Nominal .....</i>	<i>13</i>
<i>Why Buy TIPS? .....</i>	<i>15</i>
<i>TIPS vs. Nominal Bonds.....</i>	<i>17</i>
<i>TIPS vs. I Bonds.....</i>	<i>22</i>
<i>Interest Rate Changes.....</i>	<i>26</i>
<i>TIPS and Taxes.....</i>	<i>30</i>
<i>Risks in Investing in TIPS .....</i>	<i>31</i>

*Contents*

*How to Buy TIPS* ..... 34

**Chapter 3 TIPS Funds and ETFs..... 37**

*Fund vs. Individual Bonds*..... 37

*Understand Yield Numbers*..... 41

*Distributions*..... 44

*Open-End TIPS Mutual Funds*..... 46

*TIPS ETFs*..... 48

**Chapter 4 Individual TIPS - Auctions ..... 53**

*Bond Lingo* ..... 53

*How TIPS Are Issued* ..... 54

*Why Auctions?*..... 57

*Which Account*..... 58

*Know the Schedule*..... 61

*Read the Announcement* ..... 64

*Place Order* ..... 68

*Read the Auction Result*..... 69

**Chapter 5 Individual TIPS - Secondary Market..... 73**

*What Is the Secondary Market?*..... 73

*Why Buy on the Secondary Market?*..... 75

*Understand TIPS Quotes*..... 76

*When to Buy*..... 81

<i>Which TIPS?</i> .....	88
<i>Where to Buy</i> .....	91
<i>Selling</i> .....	97
<b>Chapter 6 Holding TIPS</b> .....	<b>100</b>
<i>How TIPS Are Adjusted for Inflation</i> .....	100
<i>TIPS During Deflation</i> .....	102
<i>Original Issue Discount (OID)</i> .....	106
<i>Bond Premium Amortization</i> .....	109
<i>Market Discount</i> .....	113
<b>Chapter 7 TIPS Strategies</b> .....	<b>116</b>
<i>How Much In TIPS</i> .....	116
<i>TIPS Fund or Individual TIPS</i> .....	118
<b>Appendix: TIPS Data and Resources</b> .....	<b>120</b>
<i>Government Data</i> .....	120
<i>News Media</i> .....	122
<i>My Spreadsheets</i> .....	122
<b>About the Author</b> .....	<b>125</b>
<b>Index</b> .....	<b>127</b>





## Preface

This short book is all about TIPS – the inflation indexed bonds. I invest in TIPS because they provide unique inflation protection not found elsewhere.

The financial media write much more about stock investing than they do about bond investing. Many investors say they don't understand bonds. With the added complexity of inflation indexing, investing in TIPS can be even more confusing.

*Mystery no more!* In this book I will share with you all the details a retail investor would ever need to know about TIPS and how to invest in them. I will also share with you the tools I created to help you make decisions.

This is not a book on investment theory. Everything is meant to be practical. I go into details most other books gloss over. I write from a retail investor's perspective because I *am* a retail investor. I learned almost everything in this book from my own experience investing in TIPS.

No prior knowledge is required. Even if you know nothing about TIPS now, after you read this book, I hope you will be comfortable investing in TIPS.

## ***Acknowledgement***

I'd like to thank Austin Frakt and Mike Piper. This book would not be possible without them.

Austin and Mike were very generous to me with their time. They thoroughly reviewed a draft of this book. I can't thank them enough for their valuable feedback and encouragement.

Austin is an Assistant Professor and a health economist at Boston University. He writes a great blog at *TheIncidentalEconomist.com*.

Mike Piper is the author of several books, including *Investing Made Simple*, *Taxes Made Simple*, and *Oblivious Investing*. I read Mike's blog every day at *ObliviousInvestor.com*.

# **Explore TIPS**

A practical guide to investing in  
Treasury Inflation-Protected  
Securities



# Chapter 1 Bonds Refresher

Before we dive into TIPS, let's have a refresher for some basic bond concepts. These concepts apply to all bonds, including TIPS, but they are not specific to TIPS:

- How bonds are different from CDs
- Yield and discounting future value
- The relationship between price and yield
- A bond ladder and a bond mutual fund
- Bonds and taxes

If you are already familiar with bonds in general, you can skip this chapter and go directly to Chapter 2.

## *CDs Are Bonds Too*

Most people are familiar with Certificates of Deposit (CDs). You can buy these at a bank. You give the bank a sum of money for a specified period of time. The bank pays you interest. When the term is up, you get your money back.

A CD is the simplest form of a bond. It has the basic elements of a bond. If you understand CDs, you already understand the simplest bonds.

**Issuer.** The issuer of a bond is the entity that borrows money from you. In a CD, the bank is the issuer.