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Investment Club Watch

Virginia Tech's $4.8 Million Bond Fund Banks on Risk

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The Fed cuts rates by 75 basis points.
Basis points? While the amount may seem small, when interest rates change a fraction of a percent, big changes take place in the markets, especially if you're dealing with bonds. At BASIS (Bond and Securities Investing by Students), Virginia Tech's student-run bond fund, the battle for those few basis points is especially real.

BASIS Means Business With Bonds

BASIS is a fairly new addition to Virginia Tech's investment education offerings (see "Virginia Tech's $5 Million 'SEED' Scores With Brazilian Stocks"). The program, which began in 2004, offers one of the few undergraduate-managed funds that are exclusive to bonds.

BASIS was formed to help fill the need in the finance world for college grads with fixed-income experience. Sophomore Ben Marshall, the group's CFO, explains: "There are actually more jobs in the bond market than there are in the equity market, and there are also less [student-run] bond funds. So it works out pretty well for us from a supply and demand perspective."

Of the 21 students involved in BASIS, two serve as co-CEOs, one as CFO, and another serves as account manager. The group recently reorganized themselves into four sectors: treasuries, agencies/sovereigns/supranationals, industrials and financials. Each sector has a sector head with analysts working underneath them.

" [BASIS] has a different mindset from a traditional equity fund," says Marshall. "The nature of our securities is significantly different from equity. Equity is going to look for capital gains and for where they can make money. Fixed-income in general is, instead, going to look at where the risks are."

Marshall reflects, "Since I started at BASIS, I've seen a shift in my thinking from just looking at 'the good' to seeing what my risks are -- be it for an investment or just a decision in my life."

Taking Stock of the Bond Market

There are some big differences between the stock and bond worlds. Compared with stocks, bonds are a whole lot less volatile. Bonds are essentially loans that pay their owners interest at a fixed rate for a set period. So then, when interest rates go down, a bond paying the old interest rate becomes more valuable because it's paying more money each month than a new bond would. Those are the kind of changes BASIS tries to predict and cash in on.

Unlike stocks, bonds don't have ticker symbols per se. Since a single company can put out multiple issues of bonds, issues are often identified by the company name, coupon (interest) rate and maturity date. So then, if you see the bond "CSCO 5.5 02/22/16," you'll know it means a **Cisco Systems** (CSCO) bond that pays 5.5% and matures on February 22, 2016.

Debt Analysis and Risk Management

Before buying any bonds to add to their fund, BASIS undertakes a debt analysis that's a little different from what most are used to with stocks. BASIS must not only analyze the pricing of the bond itself, it also has to take a look at the issuer's financial standing. With bonds, if the issuer flops, so does the bond.

Marshall breaks it down: "We're looking for strong securities that are going to continue to perform well into the future. We're also looking for a very well-diversified portfolio where we see an excellent return based on the amount of risk we're taking on. Risk management is one of the most important areas we work on, and it's also one of the areas we consider ourselves strongest."

BASIS is able to invest in corporate bonds rated A or above (one step above the bottom rating for investment-grade bonds), sovereign or supranational debt and government securities. Since most of these investments are more on the stable side, the group has also started using fixed-income ETFs to diversify their portfolio.

One area that BASIS doesn't put their money is in municipal bonds. Why? Because of the nature of Virginia Tech's endowment, they don't receive any tax advantages from investing in municipal bonds.

BASIS' Top Long-Term Bond Holdings

The following are BASIS fund's best-performing bonds that they've held for more than six months. Marshall suggests that the exceptional performance they have seen is largely because of a "flight to quality" in the past few months.

Top BASIS Positions Held Over Six Months

Bond Type	Coupon Rate	Maturity Date	Yield (Holding Period Return)	Projected Annualized Return
Treasury	4.25	8/14/2011	14.7%	25.241%
Corporate: Cisco Systems	5.5	2/21/2012	7.8%	15.550%
Treasury	4.5	3/30/2008	11.9%	15.193%
Treasury	3.875	2/14/2009	13.6%	14.742%
Treasury	4	2/14/2011	12.3%	14.245%

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