Most investors are familiar with the most common ways of losing money in the [fixed-income](http://www.investopedia.com/terms/f/fixedincome.asp) market, but there are other, lesser known - and equally effective - ways to drive yourself to the poorhouse using fixed-income securities. Here we attempt to survey them all, so that you can learn to avoid potential problems and better prepare for inevitable ones.

**Tutorial:** [**Advanced Bond Concepts**](http://www.investopedia.com/university/advancedbond)
**1. Trading Losses**Losing money is easy if you're buying and selling bonds as a [trader](http://www.investopedia.com/terms/t/trader.asp). Here are the principal methods to bleed cash.

* *Interest Rate Moves*As all bond traders know, when rates go up, bond prices fall. If you haven't read the rate climate effectively, you're going to get hurt. This is probably the single greatest source of trading losses in the market. (Read [*Managing Interest Rate Risk*](http://www.investopedia.com/articles/optioninvestor/08/manage-interest-rate-risk.asp) to learn how to minimize this risk.)
* *Credit* [*Downgrades*](http://www.investopedia.com/terms/d/downgrade.asp)
A couple of bad quarters or a punishing one-time event can force rating agencies to reconsider the credit-worthiness of a borrower. Should even a single notch be chipped from an issuer, its bonds will take a significant hit. (Learn more about corporate and personal credit scoring in [*What Is A Corporate Credit Rating?*](http://www.investopedia.com/articles/03/102203.asp) and [*Consumer Credit Report: What's On It*](http://www.investopedia.com/articles/04/122304.asp).)
* *Restructurings/Corporate Events*When companies are merged or bought out, go private - or public - the entire capital structure of the former corporate entity can also change overnight. Changes in corporate structure could leave bondholders facing everything from a steep loss in bond value to a big, fat nothing on their investment. Keep an eye on the following factors:
	+ The reasons for the [restructuring](http://www.investopedia.com/terms/r/restructuring.asp)
	+ What sort of financial shape the companies are in
	+ What the [prospectus](http://www.investopedia.com/terms/p/prospectus.asp) of the former bond stipulated
	+ What the new agreement mandate is
* *Liquidity-related losses (wide trading spreads)*For the most part, fixed-income products trade [over the counter](http://www.investopedia.com/terms/o/otc.asp), meaning there's not always a lot of [visibility](http://www.investopedia.com/terms/v/visibility.asp) in certain issues. You will not have access to all the relevant pricing information - specifically, information about the all-important [bid/ask spread](http://www.investopedia.com/terms/b/bid-askspread.asp). If the spread is particularly wide, you could run into trouble.

For example, you might buy ABC Company's bond for 96 when its bid/ask spread was 88/96 and then sell it a month later when it had [appreciated](http://www.investopedia.com/terms/a/appreciation.asp) and the bid/ask was 95/103 - but your sell price at 95 is still a point less than your purchase price. [Illiquidity](http://www.investopedia.com/terms/i/illiquid.asp) means your call was right, but you lost where it counted. (For further reading on liquidity risk, see [*Options Hazards That Can Bruise Your Portfolio*](http://www.investopedia.com/articles/optioninvestor/07/option_risks.asp).)

**2. Inflation**Your next opportunity to lose money comes from [inflation](http://www.investopedia.com/terms/i/inflation.asp). Very briefly, if you're earning 5% per year in your fixed-income portfolio, and inflation is running at 6%, you're losing money. It's as simple as that. (For further reading, check out [*Coping With Inflation Risk*](http://www.investopedia.com/articles/basics/08/coping-with-inflation-risk.asp) and [*Curbing The Effects Of Inflation*](http://www.investopedia.com/articles/05/061605.asp).)

**3. Inflation-Indexed Bonds Or TIPS**Here's one that not so many investors are familiar with. [Treasury inflation protected securities](http://www.investopedia.com/terms/t/tips.asp) (TIPS) (called "real return bonds" for Canadian investors) are supposed to be the answer to that inflation issue. Unfortunately, there are still three distinct ways to lose money on these investments.

* *Deflation*This is not an everyday occurrence but certainly a possibility. Because of the way values on TIPS are calculated, an extended period of [deflation](http://www.investopedia.com/terms/d/deflation.asp) could return you *less* cash on maturity than you originally invested. Your [purchasing power](http://www.investopedia.com/terms/p/purchasingpower.asp) might be intact, but you would emerge with less than a regular bond would have paid you. (To learn more about deflation, read [*What does deflation mean to investors?*](http://www.investopedia.com/ask/answers/202.asp))
* *Consumer Price Index*Changes in the calculation of the [Consumer Price Index](http://www.investopedia.com/terms/c/consumerpriceindex.asp) (CPI) could also bring losses. Again, not a daily occurrence, but it has been done and new methods of calculation are regularly being tested and promoted to result in a reduction in your TIPS' value. (Read about the differing opinions on how to calculate inflation in [*The Consumer Price Index Controversy*](http://www.investopedia.com/articles/07/consumerpriceindex.asp).)
* *Taxation*Finally, TIPS are taxed on both the [yield](http://www.investopedia.com/terms/y/yield.asp) and [capital-appreciation](http://www.investopedia.com/terms/c/capitalappreciation.asp) (CPI-linked) portions of the bond. It's quite possible that high bouts of inflation would trigger significant tax bills that would render the bond's real yield lower than the rate of inflation. [Tax-sheltered](http://www.investopedia.com/terms/t/taxshelter.asp) accounts are therefore best for holding these instruments. ([*Tax Tips For The Individual Investor*](http://www.investopedia.com/articles/01/112801.asp) can help you keep more of your money in your pocket.)

**4. Bond And Money Market Funds**There are two distinct ways to lose on funds.

* *Redemptions*Should there be a large call to [redeem](http://www.investopedia.com/terms/r/redemption.asp) from the fund (on a popular manager's departure, suspicion of corruption, etc.), management might be forced to sell off significant holdings to pay out investors. Should these issues be illiquid, both the fund and investors would realize losses. In some instances, [redemption fees](http://www.investopedia.com/terms/r/redemptionfee.asp) might also add significantly to losses. (Read more about the risks surrounding redemption in [*Common Mistakes By Fixed-Income Investors*](http://www.investopedia.com/articles/bonds/07/fixedincome.asp).)
* *Poor management*Losses in funds are more commonly the result of overly aggressive [managers](http://www.investopedia.com/terms/f/fundmanager.asp) chasing after yield from lower-quality issues - which then [default](http://www.investopedia.com/terms/d/default2.asp). (Read more about whether you should trust your fund manager in [*Is Your Mutual Fund Safe?*](http://www.investopedia.com/articles/mutualfund/07/mf_safe.asp) and [*Should You Follow Your Fund Manager?*](http://www.investopedia.com/articles/mutualfund/03/021103.asp))

**5. Foreign Bonds**Here are four exciting ways to lose your hard-earned income using the [foreign-bond](http://www.investopedia.com/terms/f/foreignbonds.asp) desk.

* *Exchange controls*Your friendly, foreign-bond-issuing nation decides to impose [exchange controls](http://www.investopedia.com/terms/e/exchangecontrol.asp). No money can leave the country. Too bad, foreigner.
* *Rate fluctuation*The exchange rate between your foreign bond issuing nation and your own takes a turn for the worse. You will very quickly lose (a lot) of money. Same goes for rising interest rates in that foreign country. Bond laws are universal: the price of your bond will drop as rates rise. (Read more about foreign exchange in [*Floating And Fixed Exchange Rates*](http://www.investopedia.com/articles/03/020603.asp).)
* *Taxation*Some friendly foreign-bond-issuing nations have not-so-friendly tax regimes. You may end up with a lot less once the local (foreign) tax man bites. If you come away with lower yields than inflation, again, you lose.
* *Nationalization*If you're searching for yield in far-off lands, chances are you'll encounter some with cultures that are unlike our own. In some of them, the government legally takes over businesses by decree. When this happens, you will realize you're not in Kansas anymore - and you will experience firsthand how [rating](http://www.investopedia.com/terms/b/bondrating.asp) agencies feel about the issue. (Read about one instance of national restructuring in [*State-Run Economies: From Public To Private*](http://www.investopedia.com/articles/economics/08/state-run-private-enterprise.asp).)

**6. Mortgage-Backed Securities**This investment offers a rather uncomplicated way to separate you from your money.

[Mortgage-backed securities](http://www.investopedia.com/terms/m/mbs.asp) (MBS) are [collateralized](http://www.investopedia.com/terms/c/collateralization.asp) by the monthly mortgage payments of John Q. Householder. When he runs into personal financial problems, or when the value of his house [depreciates](http://www.investopedia.com/terms/d/depreciation.asp) significantly, he may default on his mortgage. If enough neighbors join him, your MBS will lose a great deal of value and will likely trade without liquidity. When you finally decide to sell it, you will lose money. (Read about an example of mortgage default on a large scale in [*The Fuel That Fed The Subprime Meltdown*](http://www.investopedia.com/articles/07/subprime-overview.asp).)

**7. Municipal Bonds**Here are three ways to lose with "[munis](http://www.investopedia.com/terms/m/municipalbond.asp)".

* *Tax decreases*Yes, that's right, decreases. Municipal bonds are generally valued for being exempt from federal taxation - and often from state and local taxes. So long as those taxes are significant, there's an advantage to buying munis. But when tax rates decline, so too does the value of holding municipals - along with their prices. (For background reading on this type of bond, see [*The Basics Of Municipal Bonds*](http://www.investopedia.com/articles/bonds/05/022805.asp).)
* *Changing regulations*In order to maintain their tax-exempt status, securities like municipal bonds also have to adhere to demanding legal requirements. But laws change regularly, and so, too, does the status of municipal-bond issuers. Should this occur, your muni will be repriced against similar, higher-yielding (and lower-priced) issues.

For example, municipalities sometimes (though not often) have their [credit ratings](http://www.investopedia.com/terms/c/creditrating.asp) downgraded after agencies decide that a recent [budget](http://www.investopedia.com/terms/b/budget.asp) contains imprudent spending or an investment portfolio has suffered significant losses. A downgrade might also occur if the company that is insuring the bond loses it [AAA](http://www.investopedia.com/terms/a/aaa.asp) rating. (Read more in [*The Debt Ratings Debate*](http://www.investopedia.com/articles/bonds/08/ratings-agencies.asp).)
* *Private issuers*Finally, beware private companies that issue municipal bonds under the name of the municipality in which they operate (ex. an airline selling a municipal bond to build a new airport terminal). Not a few of these companies have gone on to default - even though the bonds received AAA municipal ratings, the [guarantors](http://www.investopedia.com/terms/g/guarantor.asp) were [private companies](http://www.investopedia.com/terms/p/privatecompany.asp). (For further reading, see [*Fatal Seduction Of The Municipal Bond Insurers*](http://www.investopedia.com/articles/bonds/08/municipal-bond-insurance.asp).)

**8. CDs**Cashing in your [certificate of deposit](http://www.investopedia.com/terms/c/certificateofdeposit.asp) (CD) early (where permitted) may trigger a penalty. When this penalty is netted out against accrued interest and inflation, chances are pretty good you'll lose money. (Read about another risk associated with CDs in [*Callable CDs: Check The Fine Print*](http://www.investopedia.com/articles/bonds/07/callable_cd.asp).)

**Conclusion**There you have it: from the day-to-day to the not-very-likely, there are far more ways to lose money in the bond market than people imagine. The good news is that, armed with this knowledge, you will be better able to avoid these financial misfortunes before they occur.

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