

MATCH GAME

Northern Bond Index Fund looks to replicate the returns of a popular fixed-income index

There are times when it pays to be a copycat.

“Anyone would have done quite well over the last 25 years matching the performance of the average U.S. investment grade bond,” says Louis D’Arienzo, portfolio manager of the Northern Bond Index Fund. “And that’s exactly what our fund is designed to do.”

More specifically, the Northern Bond Index Fund is constructed to mimic the performance of the Lehman Brothers U.S. Aggregate Bond Index. The popular benchmark comprises thousands of fixed-income securities, from hundreds of U.S. government and corporate borrowers. The Index also contains a smattering of so-called Yankee bonds — dollar-denominated IOU’s issued by foreign governments and businesses that trade in the United States.

High quality

Importantly, the Lehman Index does not contain any debt rated below investment grade.

Although the Fund may invest of up to 20% in non-investment grade securities, “we currently have no exposure to junk bonds,” says D’Arienzo. “About a third of the Index is mortgage-backed, but there is no direct exposure to subprime mortgages at this time.”

The Fund won’t own all 8,000-plus names in the Index. “Some don’t even trade anymore,” D’Arienzo says. A computer-generated statistical sample is expected to reduce tracking error to about two-tenths of one percent per year.

Of course, index funds aren’t appropriate for everyone. Investors seeking to beat the return of a market benchmark would be better served in an actively managed fund. But while D’Arienzo says such outperformance is a worthy goal, actively managed bond funds can sometimes lag their passive counterparts because of their typically higher costs.



Low cost

In general, index funds lack active management (stock picking and market timing), which sometimes gives the investor the advantage of lower fees and lower taxes. However, the fees involved with attempting to mirror an index will always reduce the return to the investor relative to the index. “Cost savings may make a big difference over time, especially in the fixed-income market,” says D’Arienzo. “Plus, we’re not placing bets on which sector will be hot at a given time. Investors in our Fund know exactly what they’ll be getting: broad and consistent exposure to the U.S. investment-grade bond market.”

Even if he has to copy to do it. ■



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