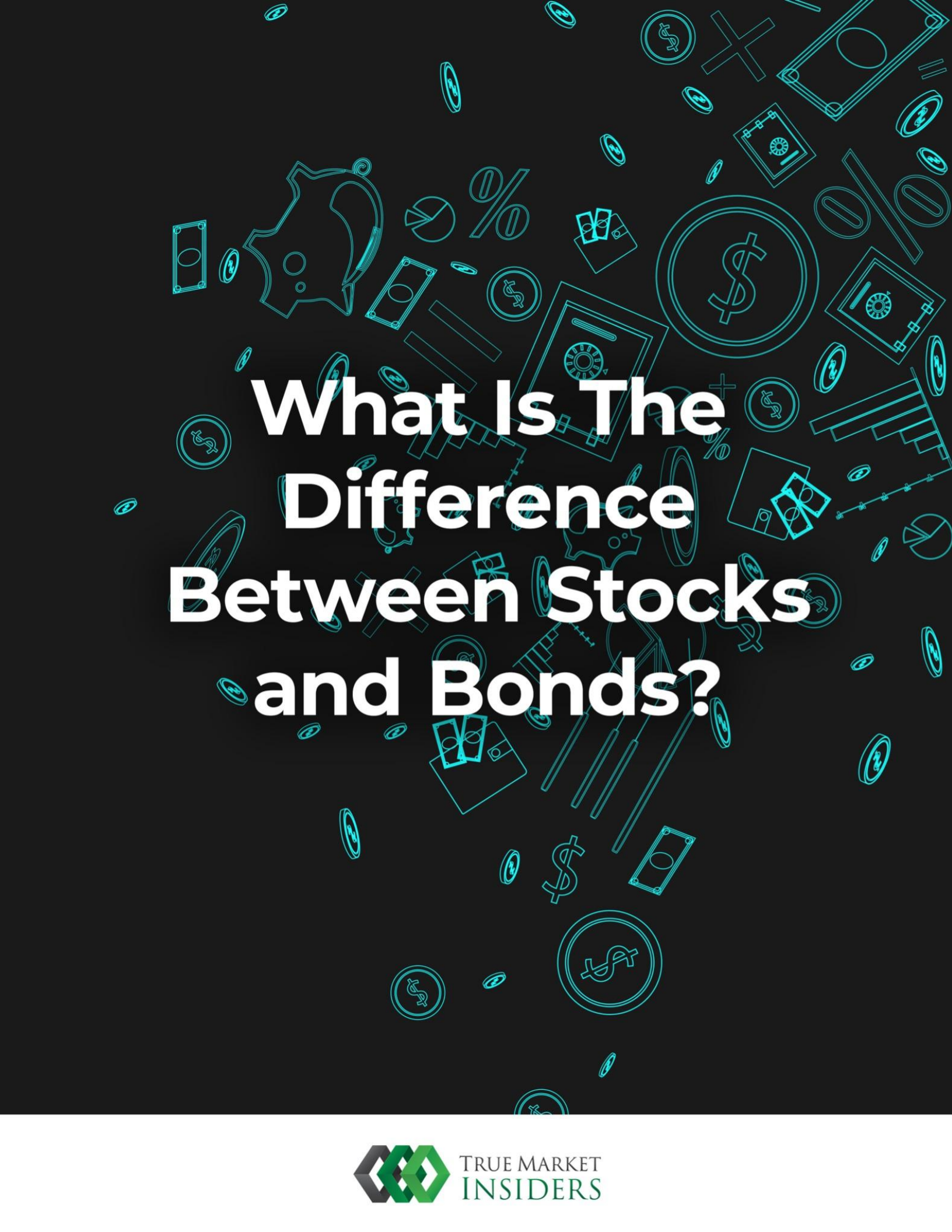


A dark background filled with various light blue line-art icons related to finance and economics. These include dollar bills, coins, a piggy bank, pie charts, percentage signs, a bar chart, a line graph, a calculator, a briefcase, and a large dollar sign inside a circle.

What Is The Difference Between Stocks and Bonds?



TRUE MARKET
INSIDERS

What Is the Difference Between Stocks and Bonds?

Click a link to jump to a section

[Understanding Stocks](#)

[Common Stocks](#)

[Preferred Stocks](#)

[Understanding Bonds](#)

[Corporate Bonds](#)

[Government Bonds](#)

[Municipal Bonds](#)

Other than a simple savings account, the two most popular methods of investing are in **stocks** and **bonds**.

In this bonus report, we celebrate **Financial Literacy Month** by examining key differences between the two. (There's more than you might imagine.)

You'll also learn about the two types of stocks and 10 types of bonds, including who issues them and why.



Source: Experian

What Is the Difference Between Stocks and Bonds?

Understanding Stocks

First, let's cover some basics.

While stocks—as well as many types of bonds—may be traded on a public market, the similarity ends there.

In basic terms, stocks are a form of equity, and bonds are a form of debt.

Stocks represent fractional *ownership* of an issuing company. A bond is akin to a *loan*.

As a company grows, it needs more and more capital to fund its expansion. So, it splits up its “pie” into smaller and smaller pieces. The idea being that as a company grows, those smaller pieces, or shares, become exponentially more valuable.

Shares of privately held companies are not very liquid, if at all. In other words, they cannot be easily sold unless the holder can find a buyer, and then, only if the issuing company allows it.

Although private stocks aren't registered with the **U.S. Securities and Exchange Commission (SEC)**, there are regulations that still apply to their purchase and sale. Additionally, private companies are not required to report their financial condition and other information to investors.

Shares in publicly held companies are usually much more liquid. That's simply because there are vastly more people interested in buying or selling them. Shares of publicly traded companies are also highly regulated by the SEC.

What Is the Difference Between Stocks and Bonds?



In pre-digital days, shares of a public company were issued in the form of physical stock certificates. But these days, stocks are usually held in **street name**.

When you buy shares of a publicly traded company, your broker/dealer holds an accounting of them in the electronic ledger referred to as street name. That makes it far easier and faster for investors to buy and sell shares of various companies.

As an investor, it's vital that you understand that stocks are unsecured by any sort of collateral. Their value moves up and down as they trade on any given market.

Most U.S. stock, and a good portion of international stocks, trade via the world's largest market, the **Nasdaq Stock Market** (a dealer market) or via the **New York Stock Exchange** (an auction market).

There is also the **OTC Markets Group, Inc.** (OTC meaning over-the-counter), which is a decentralized group of dealers that typically make markets in small companies. While most of those companies are registered with the SEC, they don't qualify for the Nasdaq or the NYSE.

As well, some very large foreign companies, which are not fully registered with the SEC, may be traded on the **OTC Pinks**.

What Is the Difference Between Stocks and Bonds?

It's very important for investors to understand that most OTC-traded stocks tend to trade less actively, so they're often more volatile, and offer less liquidity than stocks traded on the NYSE or Nasdaq.

Regardless of where a stock trades, if the issuing company should fail financially and be dissolved, common shareholders are last in line to receive any sort of compensation for their ownership, if any at all.

And that brings us to the next point. There are actually two types of stock a company may offer - **common** and **preferred**.

Common Stocks

As the name suggests, common stock is the most commonly offered, and the type that most investors hold.

Usually, each common share allows the holder to cast one vote in elections for boards of directors and in other matters of importance, such as tender offers or outright acquisitions.

Though not required to do so, highly profitable companies usually pay dividends to their common shareholders. Dividend amounts can move up and down according to a company's profitability.

Preferred Stocks

On the other hand, preferred shareholders are usually paid set dividends. They're also paid before common shareholders, so they get "preference." Yet, generally speaking, preferred shareholders have no voting rights.

If a company is dissolved, the preferred shareholders will get a shot at any liquidated assets before the common shareholders.

Which is a great segue to bonds because corporate bondholders stand ahead of even preferred shareholders in the case of liquidation.

But first, in thinking about bonds, many investors turn to bonds as inflation hedges. Here's a short video that will tell you about an even more powerful inflation-beating way to invest, year in and year out, no matter what the market's doing. You can watch it [right here](#).

What Is the Difference Between Stocks and Bonds?

Understanding Bonds

Unlike stocks (equity) in a company, bonds are, as mentioned, debt instruments. They're fixed obligations, somewhat like loans. Companies must repay bonds at a set date, or maturity. Bonds may be set up on static or variable interest rates.

The only folks ahead of a corporation's bondholders are its senior debtholders (usually banks).

Corporate Bonds



Although corporate bonds can be backed by a company's collateral, they're usually based solely on the company's creditworthiness.

Unsecured corporate bonds may be called **debentures**. Debentures are very similar to bonds, but usually they're set up for a very specific purpose.

And sometimes, companies may offer **convertible bonds** (and/or debentures) that, under certain circumstances, may be converted or exchanged for common stock. Corporate bonds are usually traded over-the-counter, and they're regulated by the SEC. And like common and preferred stock, corporate bonds are fully taxable.

What Is the Difference Between Stocks and Bonds?

Government Bonds

Generally speaking, government bonds refer to those backed by central governments. Although investors may buy bonds issued by international governments, we're focusing on those from the U.S.

Considered to be the safest of all bonds, **treasury bonds**, or **treasuries**, are backed by the “full faith and credit” of the government. They're traded on an over-the-counter basis, and regulated by the **Bureau of Fiscal Service**.

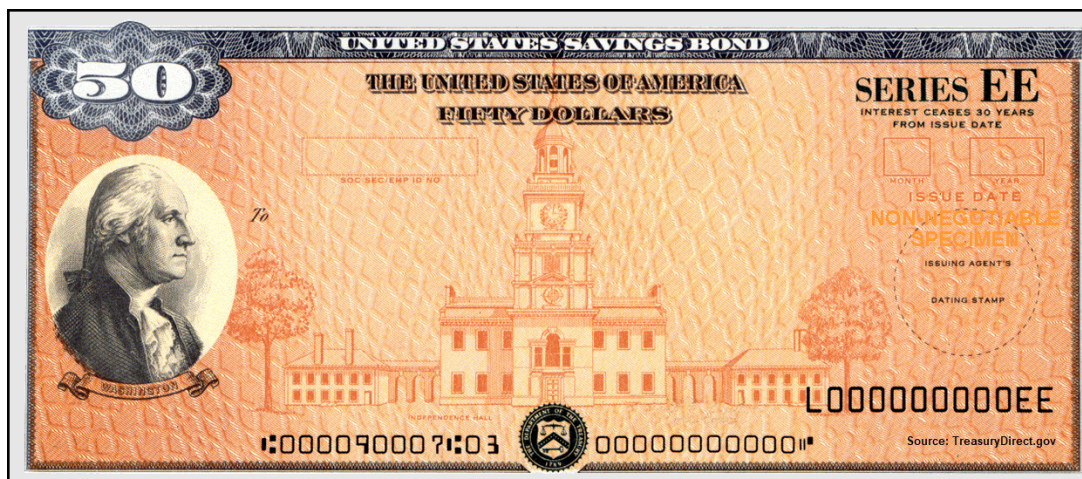
First, we consider long-term, fixed principal treasury bonds with 30-year maturities. And there are outstanding fixed principal bonds with terms from 10 to 30 years. Interest on those bonds are paid semiannually and the principal is paid at maturity.

There are also **treasury bills** or “**T-bills**.” They're non-interest bearing, short-term securities with maturities of only four, 13, 26 and 52 weeks. T-bills are bought at a discount to face value or **par**, and their face value is then paid at maturity. T-bills are traded over-the-counter.

Next, we have **treasury notes**, sometimes called “**T-notes**.” They're fixed principal instruments with maturities of two, three, five, seven and 10 years. Interest is paid semi-annually, and principal is paid upon maturity. T-notes are traded over-the-counter.

Interest on all treasuries is subject to federal income tax, but not to state or local taxes.

Then there are U.S. **Savings Bonds**. Unlike the three bonds mentioned above, savings bonds may be purchased in much smaller increments than They earn interest that is taxable by the federal government, but not by state or local governments.



What Is the Difference Between Stocks and Bonds?

From their purchase price, **Series EE** bonds are guaranteed to double in value at their 20 year maturity. The EE series is issued electronically, starting at \$25, and in higher increments, down to the penny.

And **Series I** bonds have a variable yield based on inflation rates. Interestingly enough, the Series I bonds may be issued in paper form as payment of an individual's tax refund, starting in denominations of \$50.

And unlike the three types of treasuries mentioned above, savings bonds are not liquid. In other words, savings bonds are not tradable.

Mortgage-Backed Securities (MBS)

There are also **mortgage-backed securities** or "**MBS**." They are bonds that are secured by home or other real estate loans. Unlike other government bonds, MBS receive monthly payments of interest and principal. They trade on secondary markets. Generally speaking, there are three types of MBS.

There are those issued by **government-sponsored enterprises** or "**GSEs**," such as the **Federal National Mortgage Association (Fannie Mae)** and **Federal Home Loan Mortgage Corporation (Freddie Mac)**.

There are others issued and backed by the federal government, such as **The Government National Mortgage Association (Ginnie Mae)**.

And finally, there are MBS called "**private labels**," that are issued by large investment banks or even homebuilders. They are not backed by the federal government or by any other governmental body.

And there are also other **Agency Securities**. They're bonds that are issued and secured by either the federal government or those that are issued by GSEs. Those include MBS as well as **Federal Agricultural Mortgage Corporation** or "**Farmer Mac**" and a few others.

Finally, there are also bonds that **The U.S. Department of the Treasury** offers to help protect investors against inflation. They're backed by the "full faith and credit" of the U.S. government.

Treasury Inflation Protected Securities (TIPS) are issued with a minimum investment of \$100, and maturities of 5, 10 and 30 years. The principal is adjusted semi-annually for inflation, and based upon the **Consumer Price Index-Urban Consumers**.

What Is the Difference Between Stocks and Bonds?

So, if inflation rises during the life of the TIPS, interest payments will increase. At maturity, if the adjusted value is greater than the face or par value, the investor will receive the greater amount.

They can be purchased through the U.S Treasury, in exchange-traded-funds or mutual funds that specialize in TIPS.

As an investor, you should note that TIPS can be highly volatile.

Municipal Bonds

And finally, there are also **municipal bonds**, often called simply “munis.”



These bonds are issued and backed by a state, county or city. Munis are often used to finance things like schools, parks, water and sewer systems, even roadways. Their maturities are often quite lengthy, up to 30 years, though some are issued for terms as short as two years.

As munis are free from federal income tax, they've long been considered a form of a tax shelter for the very wealthy.

What Is the Difference Between Stocks and Bonds?

But, the interest rates of Munis are generally pretty low. In fact, a rule of thumb with bonds is: “the safer the bond, the lower the rate.”

Munis are generally issued in minimum denominations of \$5,000. Although, in smaller issues, sometimes that minimum will be dropped to \$1,000 in effort to attract local investors.

Munis usually pay interest semi-annually. They’re issued on a primary market and later, traded on a secondary, over-the-counter market. Municipal bonds are regulated by **The Municipal Securities Rulemaking Board**.

And there you have it, a primer on stocks and bonds.

Keep your eyes peeled for more special Reports like this one.

And here’s to your greatest investing success.

Laurie S. Roop
True Market Insiders

April, 2022



What Is the Difference Between Stocks and Bonds?

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What Is the Difference Between Stocks and Bonds?

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