## Bonds 101 – a "Quantum of Solace" for your portfolio…

With investment markets around the world continuing to be "shaken and stirred" daily, it may be prudent to consider an asset class that is both income producing and considered capital stable.

Enter Bond…James Bond or in this case Fixed Interest investment.

The Fixed Interest Market (aka the Bond Market) is a relatively new investment space in an Australian context, particularly direct investment or purchase of individual bonds.

The Bond Markets in the United States and Europe are older and larger than their own equity markets. The Australian Bond Market is relatively new in comparison but it is evolving and now investors can access Bonds directly with as little as A$10,000 per Bond.

Professional Investors are well versed in the benefits of Bonds in a diversified portfolio. For example if we look at a breakdown of QBE's 2015 US$26Bn Investment Portfolio, it reveals 88% or almost US$23Bn is in Fixed Interest investments.

This includes; US$5.9Bn (22.8%) Short Term Money Markets ie Term Deposits, US$4.2Bn (16%) Government Bonds and US$12.4Bn (47.6%) Corporate Bonds.

## So what is a bond?

A bond is simply a loan or an IOU from an investor to an issuer (such as the government, a bank or corporation).

Think of the loan you take out from the bank to buy a house. The bank expects to be repaid interest and principal. If you fail to make the payments you break the contract and the bank has rights to recover its funds.

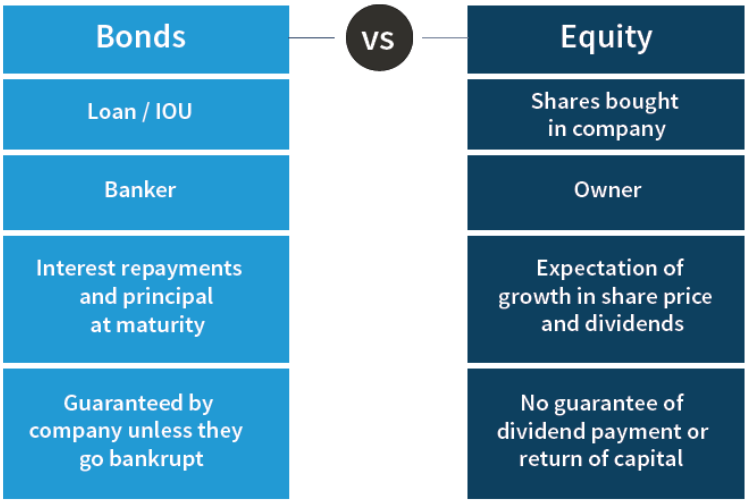
Bonds work in much the same way. The investor agrees to lend the money to the issuer who must then honour that legal obligation by paying back interest and principal.

They are issued in a format that allows this debt to be traded easily by investors, after the money has been lent (issued) and before it has to be paid back (maturity).

### Different Types of Bonds

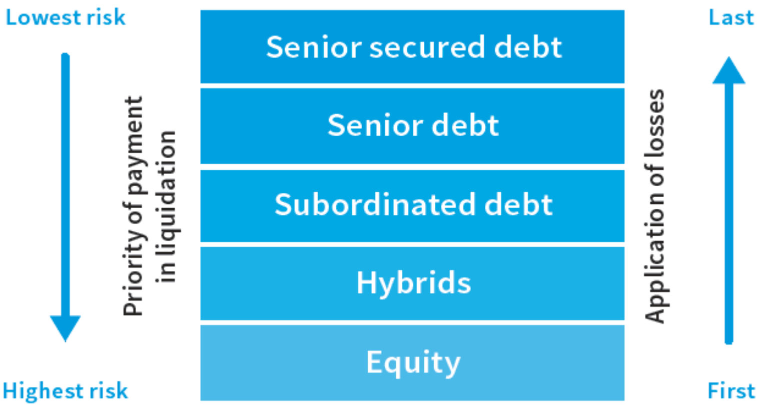
- Fixed rate bonds – A fixed rate bond pays a fixed return for the life of the bond, known as the coupon rate.
- Floating rate bonds – A floating rate bond pays income linked to a variable benchmark. The margin over the benchmark is fixed and set at first issue, and income will rise and fall over time as the benchmark changes.
- Inflation linked bonds (ILBs) – An ILB is a security linked to the Consumer Price Index (CPI) or inflation. Therefore the capital value of the bond grows with inflation. There are two main types: capital indexed bonds and index annuity bonds.

**Bonds vs Equities**
There are some major differences between bonds and equities, as illustrated below:




**Capital stability**

Importantly, bond holders have priority over equity holders in the event of liquidation. Assuming the issuer of a bond remains solvent, they are contractually obliged to pay back the principal value to the bond holder.




**Why Bonds?**

In addition to capital stability (see above), some key benefits of bonds include:

- **Regular income -** The bond interest earned is determined by a formula and must be paid.
- **Diversification -** Bonds provide a different type of return to shares and property.
- **Liquidity -** Bonds can be bought and sold prior to maturity.

**How can I find more information on Bonds and how can I access the market?**

Please visit www.fiig.com.au and thewire.fiig.com.au or contact David Hann - Director Fixed Income Sales, FIIG Securities Limited on (08) 9421 8503.