

# INTRODUCTION TO FIXED INCOME

Continuing Education Programme

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Client Portfolio Manager



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# AGENDA

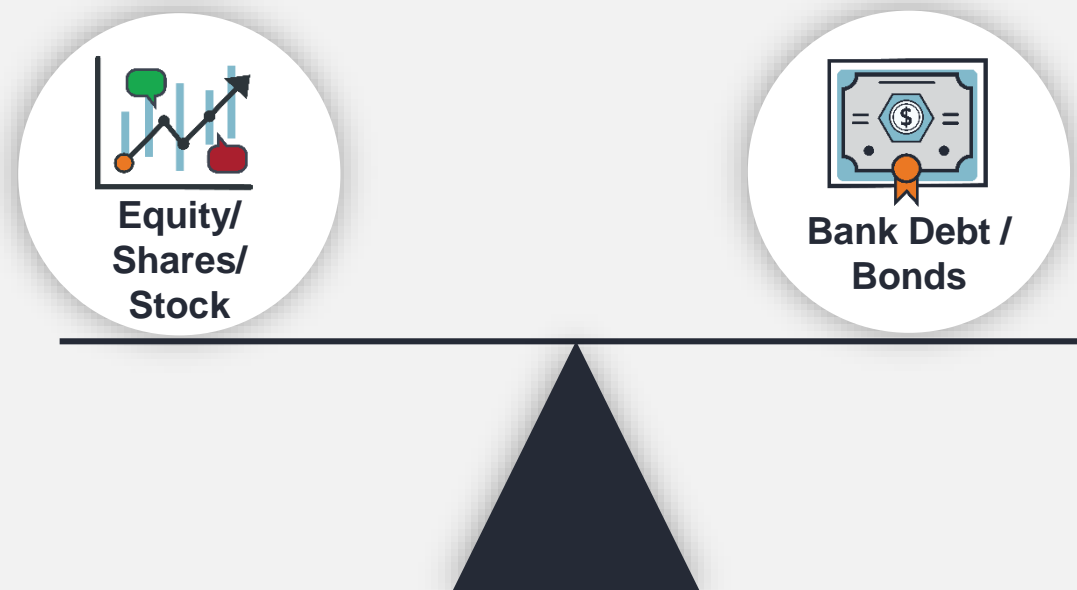
- What are bonds?
- Why are bonds important?
- Overview of the bond markets
- Yield, price and duration
- What determines the interest rate
- Analysing bond markets
- Role of bonds in an overall portfolio



# WHAT IS A BOND?

- Businesses need capital to grow
- Two different types of capital; debt & equity
- Plusses and minuses to both
- A bond is a loan of capital which receives interest and must be repaid
- Bondholders get *paid first, but don't get ownership or voting rights* \*
- Equity holders appoint a Board and have a say in the management of the company

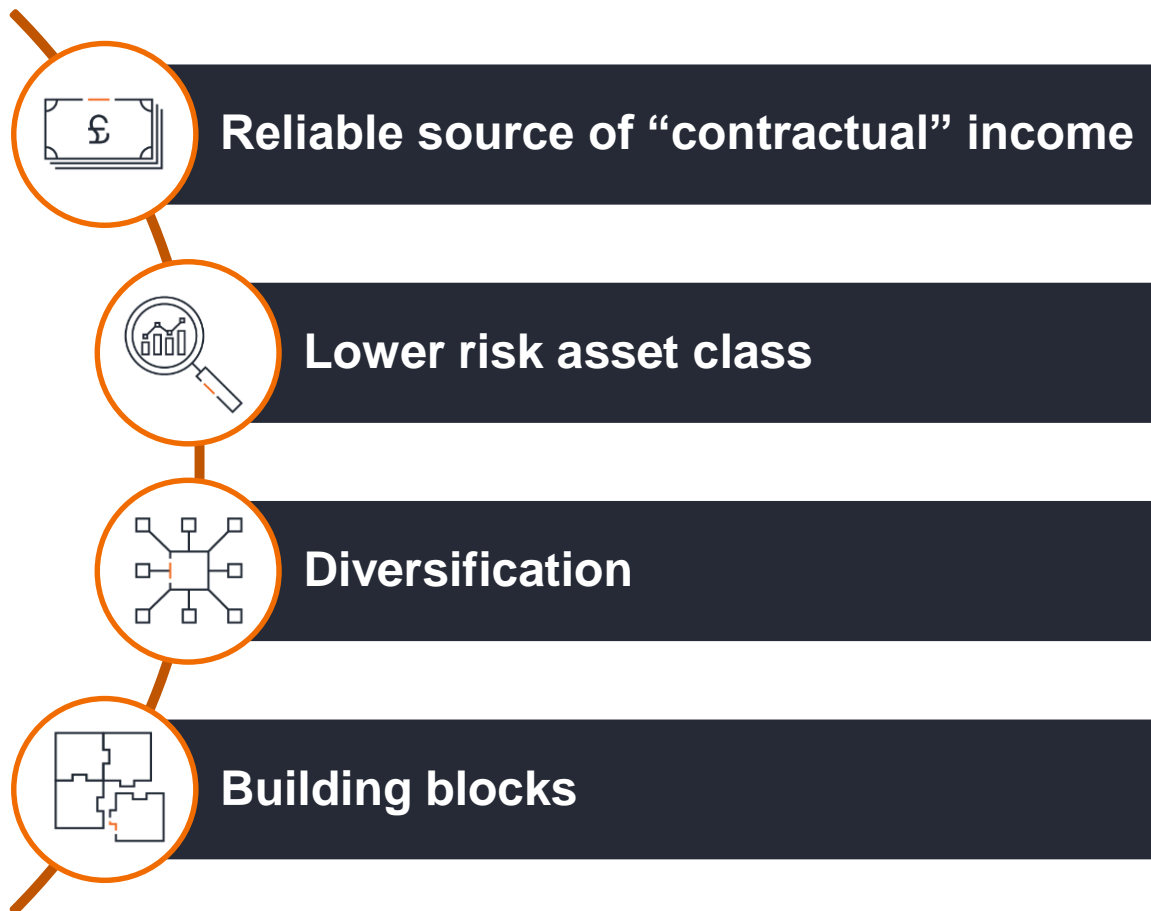
**Bonds are debt.**  
**Bondholders are creditors of the company.**



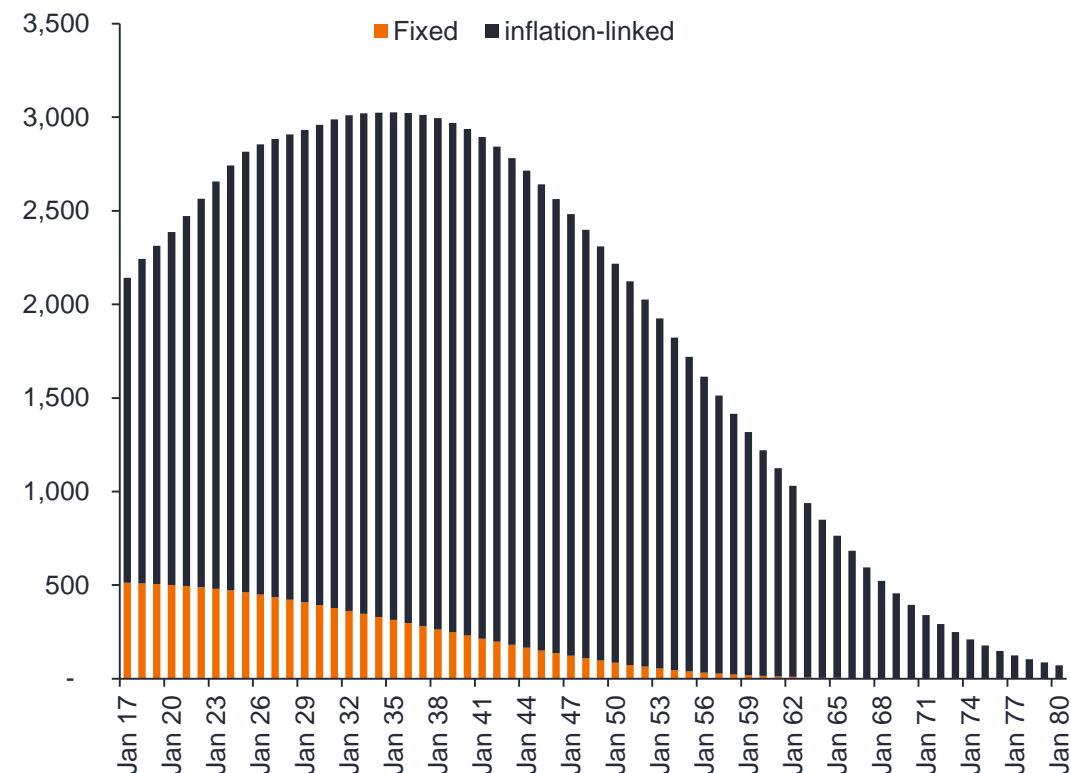
Source: Janus Henderson Investors as at 31 March 2021

Note: \*Some exceptions

# WHY ARE BONDS IMPORTANT?



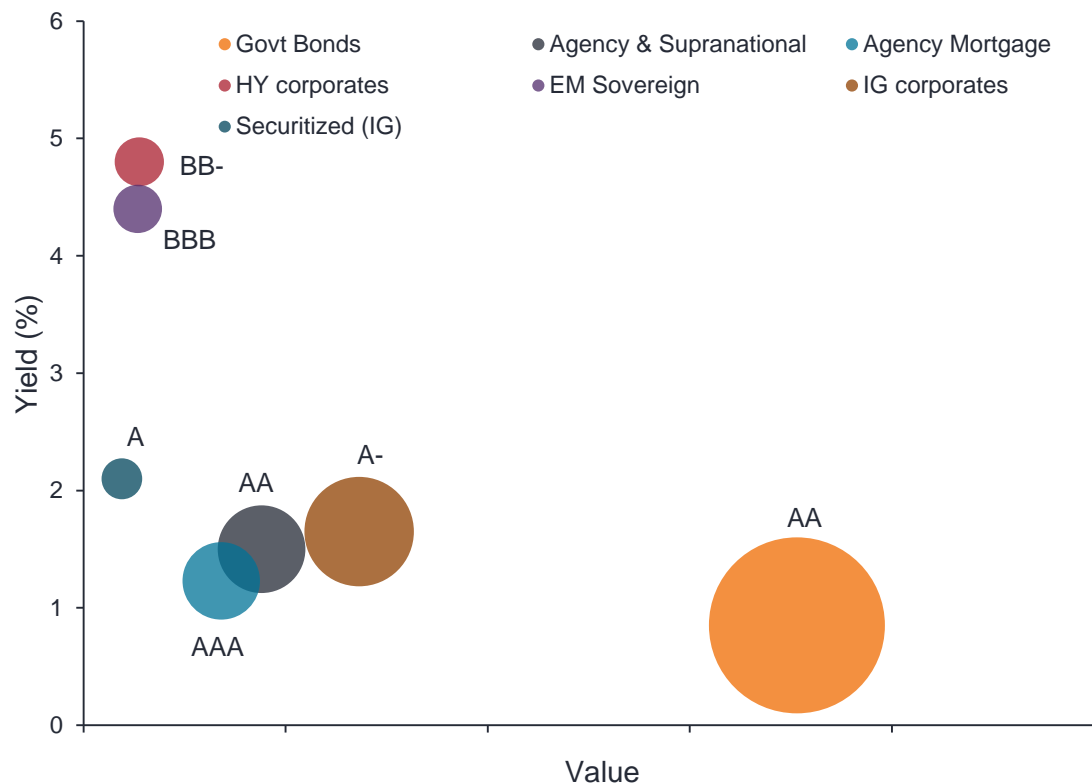
**Pension Scheme Liabilities**



# OVERVIEW OF THE BOND MARKET

## Size of Global Bond markets

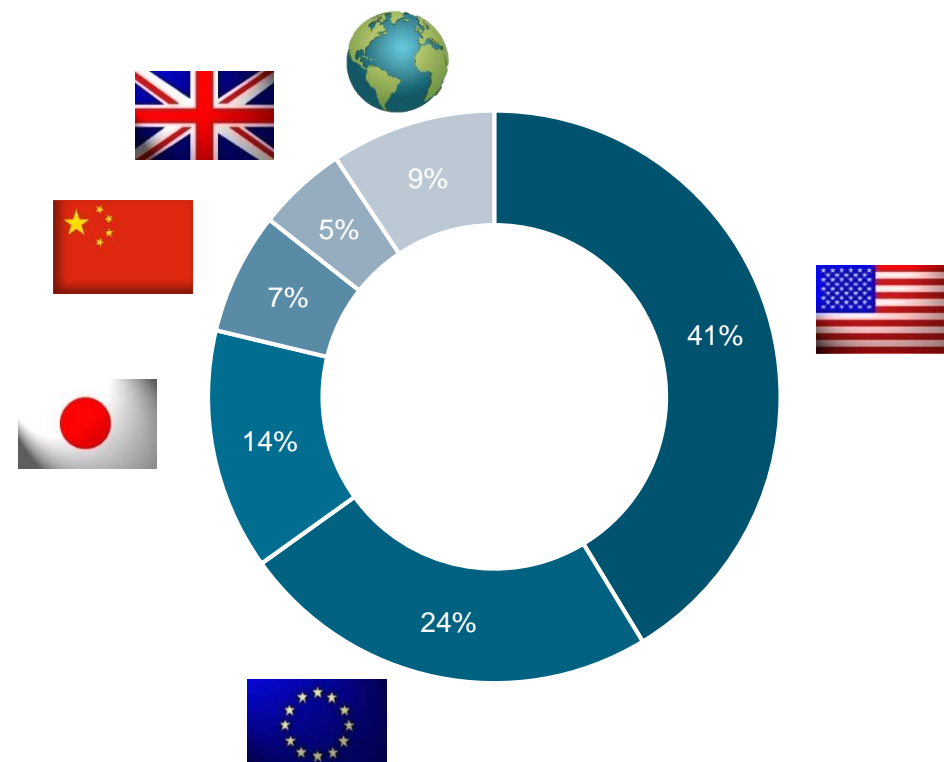
Size and Yield of Global Bond Market



Source: ICE BofAML Global Broad Market Index (GBMI), as at March 2021

Note: Size of circle indicates greater value

Top Issuer Weights by Country in the Global Broad Market Index



Source: Bloomberg, as at 31 March 2021

# WHAT ARE BONDS?



**bond** (*noun*); debt security or loan agreement, obligation or promise.

## Bond Yields Explained

$$\text{Yield} = \text{Interest payments (coupon)} + \text{Capital gain or loss}$$

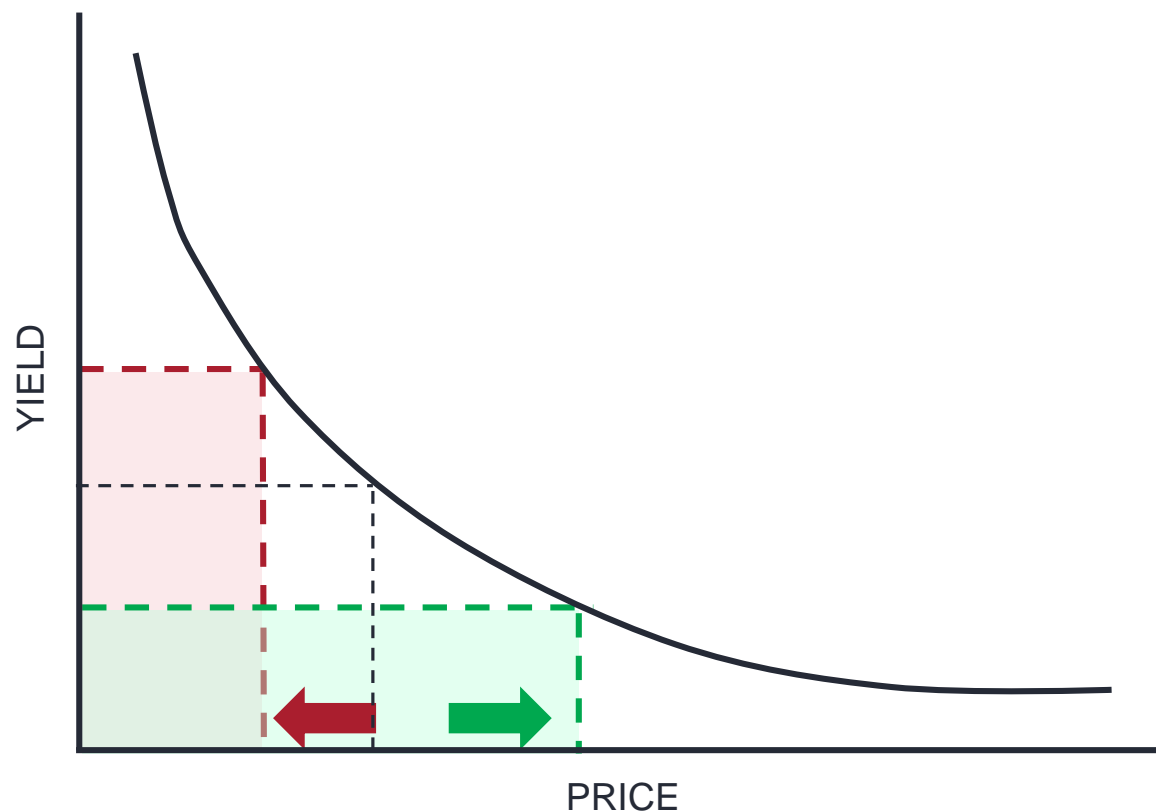
- Yield to maturity is the expected return earned on average if the bond is held to its maturity

J.P.Morgan	2.58%	\$1,000	2031
ISSUER	COUPON	PAR VALUE	MATURITY
<ul style="list-style-type: none"><li>Name of issuing corporation or body</li></ul>	<ul style="list-style-type: none"><li>Amount of interest</li><li>Fixed at issue (usually)</li><li>Expressed as % of par value</li></ul>	<ul style="list-style-type: none"><li>Minimum 'unit' of securities</li><li>Amount to be repaid on each security at maturity</li></ul>	<ul style="list-style-type: none"><li>Debt becomes due</li><li>Capital repaid</li><li>Interest ceases</li></ul>

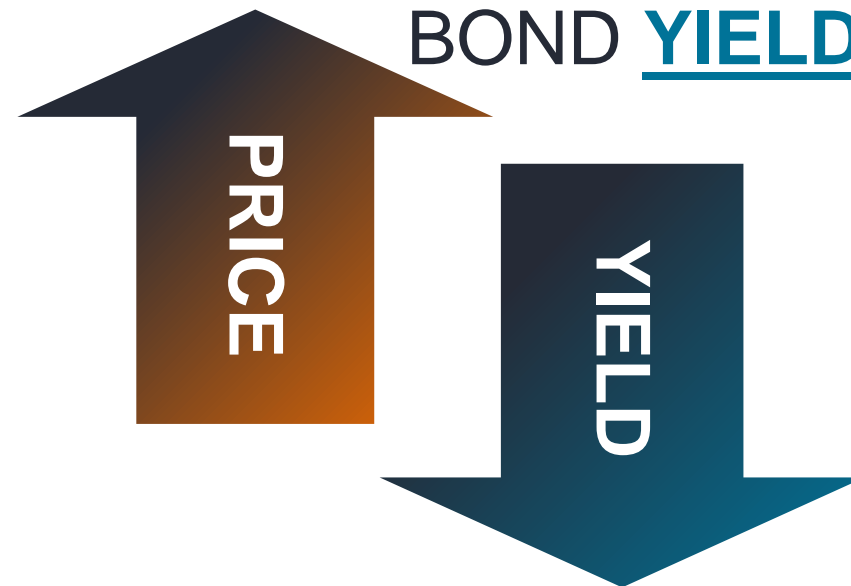
This month, JP Morgan raised \$13bn in bonds across tranches, which is the largest bank deal ever.

The 2031 bonds were \$3.5bn in size.

# RELATIONSHIP BETWEEN YIELD AND PRICE

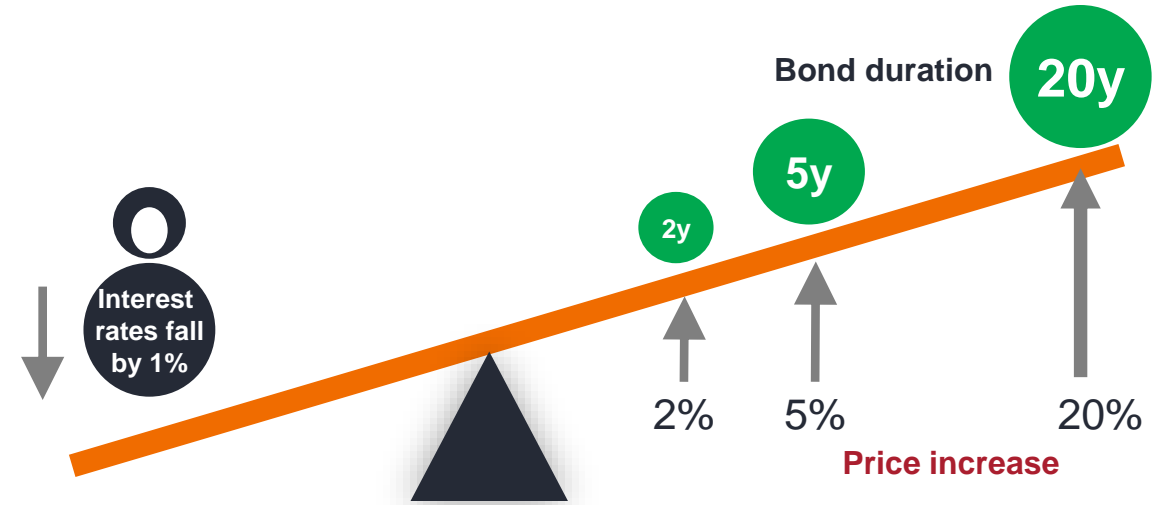


BOND PRICE  
VERSUS  
BOND YIELD



# WHAT IS DURATION?

- **Duration** = Weighted average term to maturity of a bonds cash flows, including the repayment of capital at maturity
- The longer the time until the cashflow (duration), the greater the sensitivity of price to a change in to changes in the interest rate (yield)
- The duration measure allows us to compare bonds with different terms (maturity) and coupons





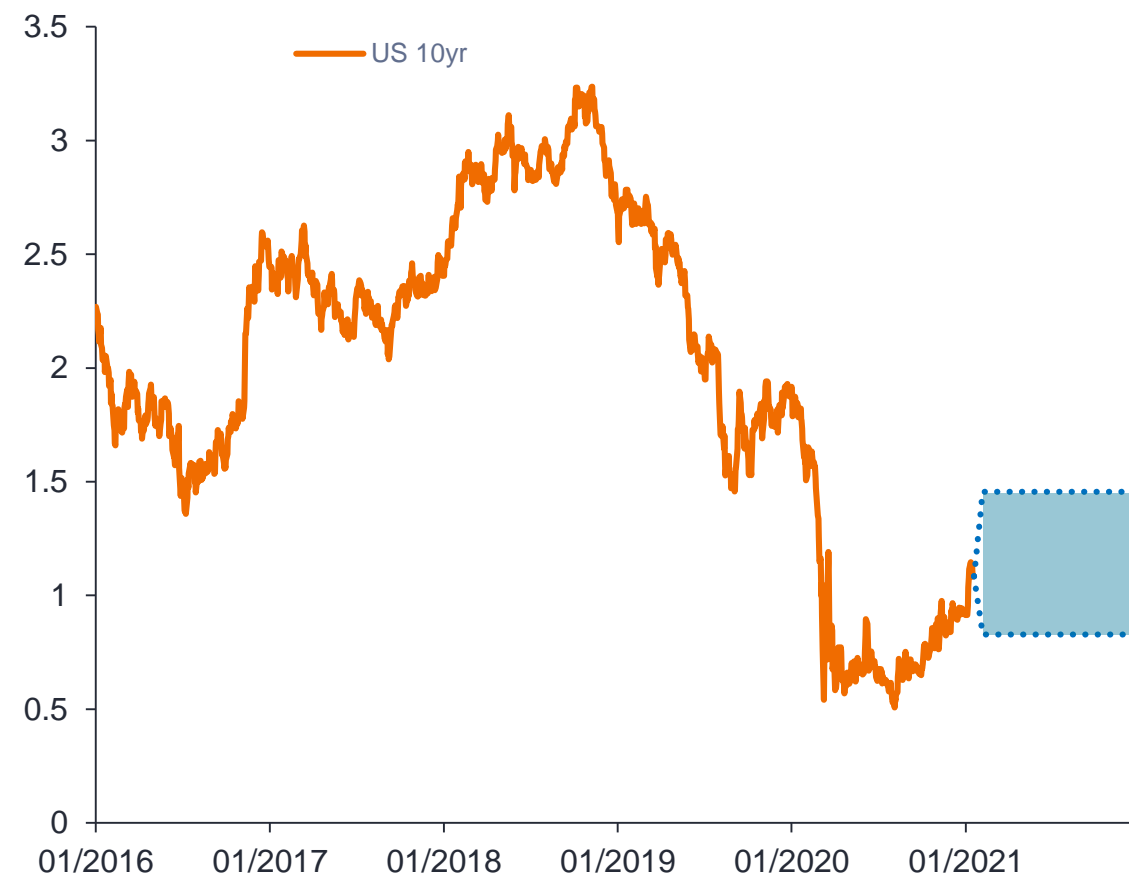
# THINKING DURATION...

*Put these instruments in order of duration  
(from lowest to highest):*

- A)** 10 year German Bund – DBR 0% 15 February 2031
- B)** “Average” pension scheme liabilities
- C)** 1-10 yr Global Government Bond ETF
- D)** Mexico £ 5.675% March 2114

# ANALYZING BOND MARKETS

Current 10yr note		0.91			
10yr yields (%)		Terminal rate scenarios			
End 2020		2.50%	2.00%	1.50%	1.00%
Time to first hike	2yr	2.03	1.68	<b>1.33</b>	<b>0.98</b>
	3yr	1.81	1.51	<b>1.20</b>	<b>0.90</b>
	5yr	1.36	<b>1.16</b>	<b>0.96</b>	<b>0.75</b>
	7yr	1.13	<b>0.98</b>	<b>0.83</b>	0.68

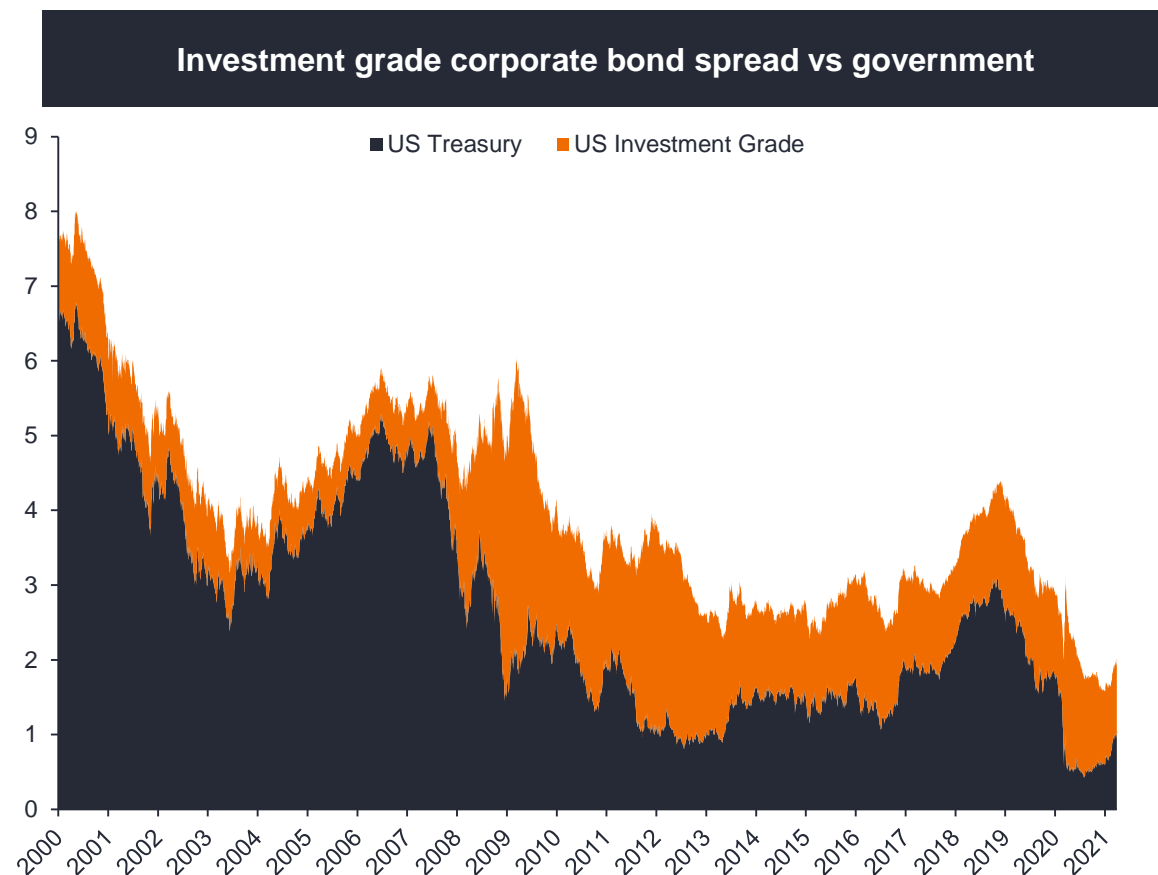


Note: Janus Henderson model based on pace and timing scenarios for interest rate hikes and term premium. Forecasts are not guaranteed to be accurate. As at 31 December 2020

# WHAT DETERMINES THE YIELD?

The ***credit spread*** compensates for:

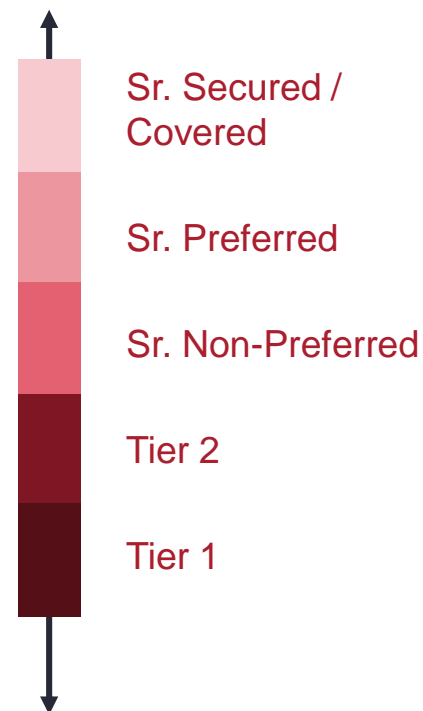
- Default (and downgrade) risk
- Illiquidity
- Return volatility



# WHAT DETERMINES THE YIELD?

S&P / Fitch	Moody's	
AAA	Aaa	<b>Investment Grade (High Quality)</b>
AA	Aa	
A	A	
BBB	Baa	
BB	Ba	<b>Below-Investment Grade (High Yield)</b>
B	B	
CCC	Caa	
CC	Ca	
C	C	
D	D	<b>In Default</b>

Financials



Corporates



# ANALYZING CREDIT MARKETS

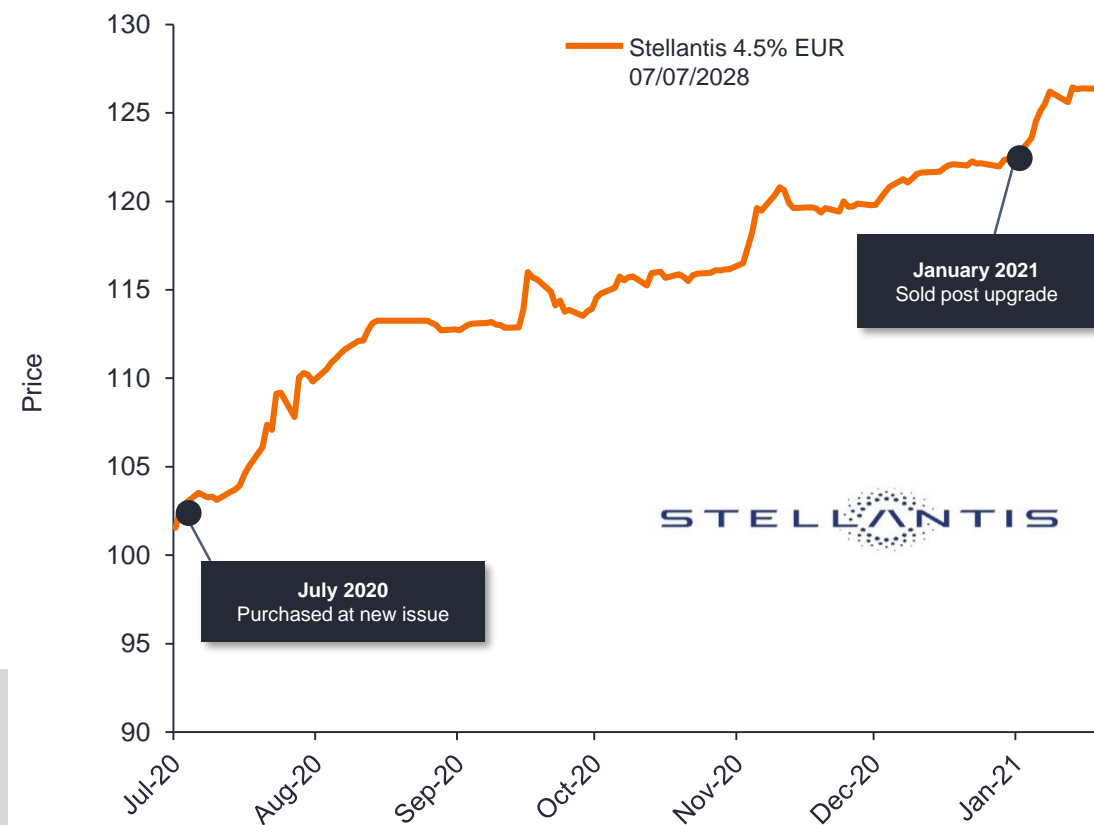
Leading European vehicle manufacturer, also with strong US presence

## Investment Thesis

- Good business performance vs peers and strong liquidity position
- Expected material rating and credit spread upside in the event the merger with higher rated Peugeot was approved - however if the deal was not approved bond relative value was still sufficient
- By 2025 (BEV, PHEV) variants to be offered on all models in Europe and 100% of light-duty range in the US

## Key principles

- ***Getting free cashflow right and evaluating the downside***
- ***Understanding management intentions***
- ***Researching bonds and companies, not just companies***



Source: Janus Henderson, Bloomberg, as at 19 January 2021.

Note: References made to individual securities should not constitute or form part of any offer or solicitation to issue, sell, subscribe or purchase, and neither should be assumed profitable. For illustrative purposes only.

# SIGNIFICANT DISPERSION OF RETURNS WITHIN FIXED INCOME

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
12.1%	14.0%	60.7%	15.3%	14.1%	18.9%	9.0%	7.7%	3.6%	16.2%	12.7%	3.4%	14.5%	11.5%
1.0%	-29.6%	-3.7%	0.3%	-1.5%	0.5%	-9.4%	0.3%	-6.9%	0.7%	1.1%	-5.2%	2.5%	1.0%
Difference between best and worst performer													
11.2%	43.6%	64.4%	15.0%	15.6%	18.4%	18.4%	7.4%	10.5%	15.5%	11.6%	8.6%	12.0%	11.4%

Cash

US Treasuries

US Treasuries inflation-linked

Emerging market debt

Global investment grade corporates

Global high yield

Senior Asset backed securities

Secured loans

Source: ICE Bank of America Merrill Lynch, Credit Suisse, Barclays, as at 31 December 2020

ICE BofAML indices: US Treasury Master (G0Q0); US Treasuries Inflation-Linked (G0QI), Global Broad Market Corporates (G0BC) hedged to USD, Global High Yield (HW00) hedged to USD; ML US 3-month constant maturity overnight Libor; Credit Suisse Western European Leveraged Loans Index; Barclays Pan European 50/50 AAA/AA ABS FRN Composite Index (EUR); Emerging market debt is 50/50 blend of JPM GBI EM local currency index in USD and JPM EMBI Global Diversified Index

Past performance is not a guide to future performance

# BOND STRATEGIES – WHAT ROLE DO THEY PLAY?

- While bonds all have some features in common, the asset class is very diverse
- We can bucket sectors/strategies based on their expected behaviour

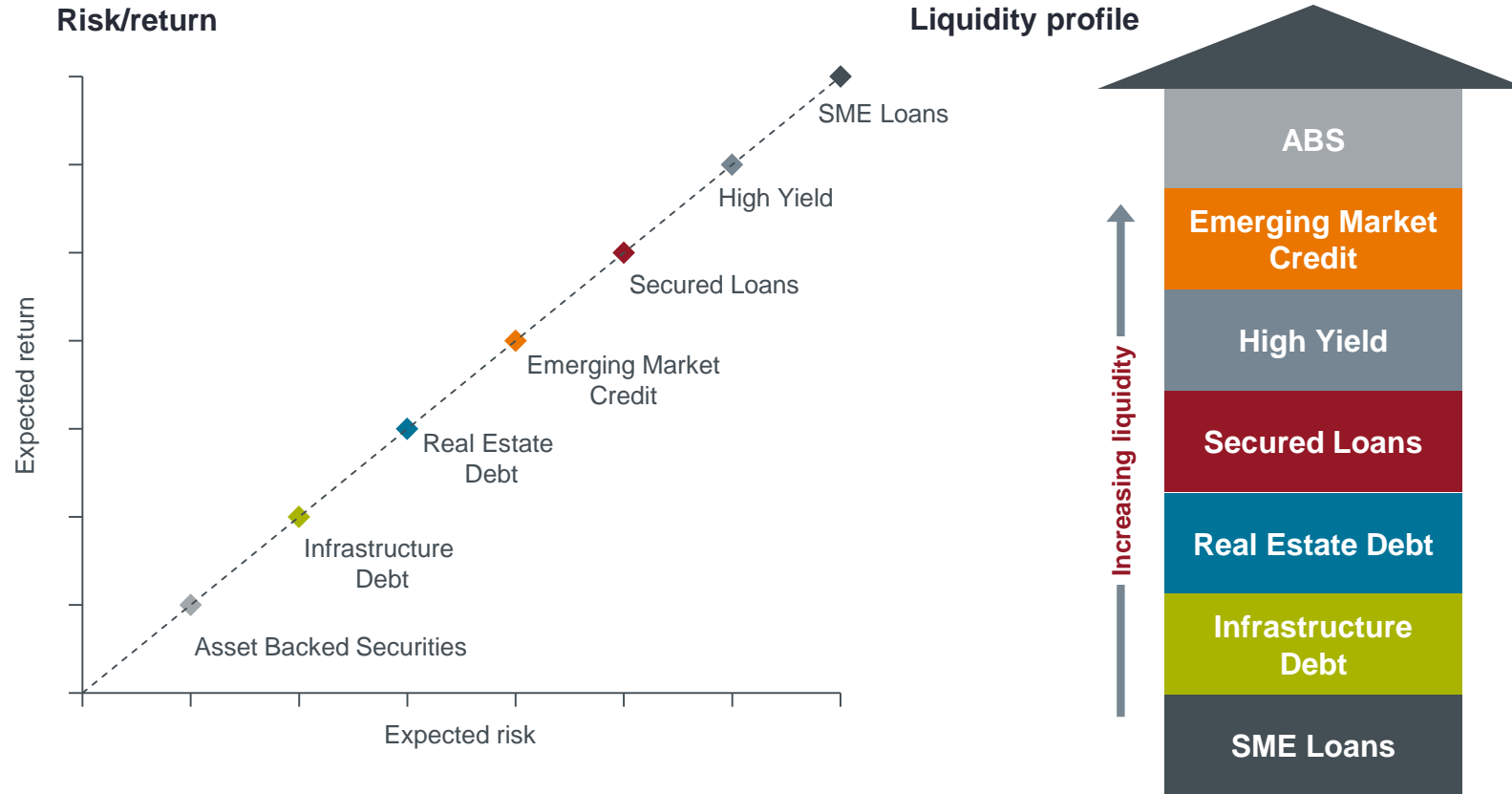
	Defence	Diversification	Income
WHAT IT IS	<ul style="list-style-type: none"><li>▪ Primary risk factor = interest rate duration</li><li>▪ High quality bonds denominated in local currency</li></ul>	<ul style="list-style-type: none"><li>▪ Variable risk factor composition, often dynamically managed</li><li>▪ Defensive growth</li></ul>	<ul style="list-style-type: none"><li>▪ Primary risk factor = credit (default) risk</li><li>▪ Lower credit ratings / illiquidity premium</li></ul>
EXAMPLES	<ul style="list-style-type: none"><li>▪ Government Bonds</li><li>▪ Inflation-Linked Government Bonds</li><li>▪ Liability Driven Investing (“LDI”)</li><li>▪ Buy &amp; Maintain IG credit</li></ul>	<ul style="list-style-type: none"><li>▪ Absolute Return</li><li>▪ Unconstrained</li><li>▪ Global Bonds (FX unhedged)</li></ul>	<ul style="list-style-type: none"><li>▪ Emerging Market Debt</li><li>▪ High Yield Bonds</li><li>▪ Secured Loans</li><li>▪ Multi Asset Credit</li><li>▪ Private Credit</li></ul>

# APPENDIX



# DIFFERENT TYPES OF CREDIT

Finding the balance between risk, return and liquidity



Source: Janus Henderson Investors, as at March 2021.

For illustrative purposes only.

SME – Small and medium enterprise.

# MANAGING BOND PORTFOLIOS

## Tools in the active bond managers kit

- **Duration / Yield Curve Positioning**
  - Moving the maturity of the bonds to capture changes in yields
- **Market Selection**
  - Buying overseas bond markets as potential return and/or yield opportunity
- **Asset Allocation**
  - Moving between different fixed income asset classes to add value
- **Security Selection**
  - More about avoiding losers than choosing winners
- **Currency Management**
  - Identifying over/undervalued currencies

# BOND RISK FACTORS

Rating	Asset class	Interest rate risk	Credit risk	Prepayment risk
IG	Cash & Money Market			
IG	Government Bonds			
IG	IG Corporate bonds			
IG	EMD			
IG	Floating rate ABS			
HY	HY Corporate bonds			
HY	Secured loans			

# BIOGRAPHY



**Matt Argent**

Client Portfolio Manager

Matt Argent is a Client Portfolio Manager on the fixed income team at Janus Henderson Investors. Prior to joining Henderson in 2009, Matt worked for Deloitte as an investment consultant and actuary.

Matt graduated with a BSc degree in economics from the University of Warwick. He is a Fellow of the Institute of Actuaries and holds the Investment Management Certificate. He has 18 years of financial industry experience.

Source: Janus Henderson Investors, as at March 2021

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