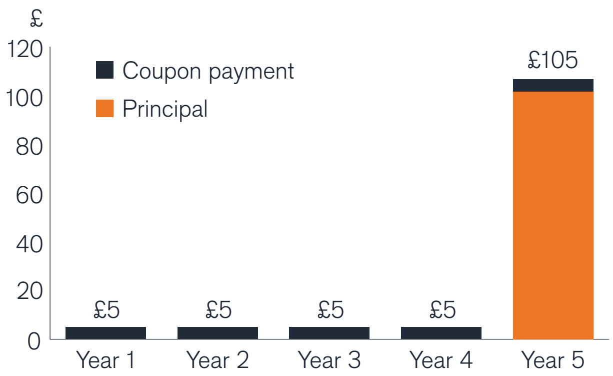
A SIMPLE GUIDE TO BONDS

Bonds are debt securities issued by companies, governments and the like. For investors, they can provide a stream of returns. In this guide we explore the structure of bonds, why bond prices go up and down, and some of the key benefits and drawbacks of investing in bonds. By speaking to a financial adviser, you can discuss whether investing in bonds is right for you.

What are bonds?

A bond is an 'I owe you' (IOU), typically issued by a government or company (an issuer). Those issued by governments are known by special names such as US Treasury, UK gilt and German bund. When issued by a company, they are referred to as 'corporate bonds' or sometimes as 'credit'. By buying a bond you are lending the issuer money. Two things are specified at the outset: the agreed rate of interest that the issuer must pay you at regular intervals (the coupon), and the date at which the issuer must repay you the original amount loaned (the principal).

To illustrate this, let's take a fictional bond issued by Enterprise Inc. Say you buy Enterprise Inc's £100 five-year 5% annual coupon bond. This means you lend the company £100 and in exchange Enterprise Inc will pay you an annual coupon of 5% (ie, £5), and repay the principal after five years.



For illustrative purposes only

What affects the price of bonds?

Bonds can be bought and sold in the marketplace. Bond prices change constantly because market participants make different assessments on two main factors: the likelihood that the issuer will repay its debt (credit risk), and the effect of interest rates (interest rate risk). We will cover this in more detail later.

If there are more investors wishing to buy a bond than sell it, its price will normally increase. On the other hand, if there are more sellers than buyers, then the price will normally go down. The rising or falling price affects the yield of the bond. The yield, which moves in the opposite direction to the price, is a way of measuring the attractiveness of an individual bond. However, bonds do not have to be held until their maturity when the principal is repaid - they can be bought and sold (ie, traded) at any time until the bond reaches maturity in what is known as the 'secondary market' (bonds are initially issued in what is referred to as the 'primary market'). So, there are many ways of calculating the yield. The most common is the 'redemption yield'. This discounts the value of coupons received over time. It also adjusts for any difference in the price paid for the bond and the principal repaid at maturity.

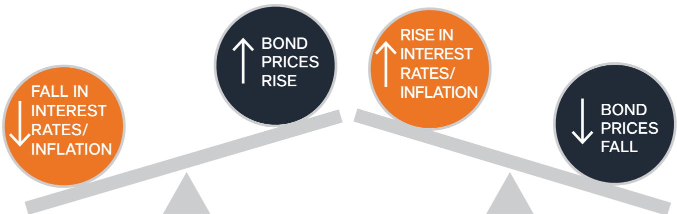
One of the simplest yield measures is the 'running yield'. Using the earlier example, imagine that after three years, Enterprise Inc's five-year 5% coupon bond is worth £95 in the market, and another investor buys the bond from you. The coupon is still £5 – this never changes as it was agreed at the outset. The running yield would be 5 ÷ 95 = 5.26%. Therefore, if bond prices fall, yields rise. If bond prices rise, yields fall.

Risks

Interest rate risk

Imagine a government pays a 5% coupon on a bond. If bank deposit rates (the interest paid by savings accounts) were to rise to 6%, investors would be able to get a better return at the bank, and with less risk to their money. Therefore, rational investors would sell the bond and put their money into a savings account. This would likely result in the price of the bond falling. Conversely, if bank deposit rates fell to 2%, the bond would represent an attractive investment and the price would likely rise.

Inflation has a similar effect. If inflation – or investors' expectations for inflation – rises, then the future purchasing power of the bond's coupon falls. Therefore, the bond is less attractive and the price will likely fall. Again, the reverse is true in times of falling inflation.



Credit risk

This is the risk of an issuer facing financial difficulty, and failing to repay its debts (including coupon and principal payments on the bonds that they have issued). Credit risk depends on issuer-specific factors, as well as wider economic and business conditions. For example, the US government issues bonds. It is generally accepted that the US government is very unlikely to default on its payments, and therefore its bonds carry very little credit risk. This low risk means US bonds are seen as relatively safe and the US can offer a low yield and still attract investors. However, a small company such as an oil producer in a less developed country faces far more uncertainty such as a volatile oil price, and could run into financial difficulties. It therefore carries a higher credit risk and investors would typically want to pay less for the bond, demanding a higher yield.

Credit ratings

Credit ratings can be useful to investors in assessing credit risk or when looking at different bonds in the market.

A credit rating can be given to an issuer, either to one of its individual debt (or bond) issues or its overall creditworthiness. In its simplest form, a credit rating is a formal, independent opinion of a borrower's ability to service its debt obligations. Credit ratings are just one of the tools that allow investors to form a view on, and compare, the relative likelihood of whether an issuer may repay its debts on time.

The rating usually comes from one of the three main credit rating agencies: Moody's Investor Services (referred to as Moody's), S&P Global Ratings (previously known as Standard & Poor's) or Fitch, which use standardised scores such as 'AAA' (a high credit rating) or 'B-' (a low credit rating).

What are the benefits and drawbacks of bonds?

- Bonds are attractive to investors because they pay a regular income and their prices are generally stable.
- Bonds issued by reputable companies or governments are generally considered safer than equities (company shares).
- Should a company that has issued bonds run into financial difficulty, the bondholders rank ahead of equity holders for repayment.
- The price of a bond can fall as well as rise. There is no guarantee that an issuer will not default on its obligations.
- The effects of interest rates and inflation can erode the future value of returns.

Bonds versus other asset classes

	Capital growth	Income	Price volatility
Bonds	Moderate growth potential	Generally higher than equities. Usually stable and regular	Generally low
Equities	High growth potential	Depends on dividends and will rise and fall	Generally high
Commercial property	Moderate growth potential	Generally high and more stable than equities	Generally lower than equities
Cash	Low growth potential	Low. Depends on interest rates	Very low

The above table is a generalisation of the asset classes. Individual securities in each asset class may behave differently.

Choosing the right bonds

Investors demand a premium for the extra risk they are taking when lending money to a less well-established company or less creditworthy government. Therefore, bonds from these issuers tend to be higher yielding. This means that they will have higher coupons and also lower prices compared to the more creditworthy bonds. Higher quality, lower risk issuers are generally referred to as 'investment grade', while higher risk, lower quality credits are known as 'high yield' or 'sub-investment grade' (see also credit ratings above). Additionally, bond prices are affected by different factors depending on the type of issuer. For example, bonds issued by governments tend to be more affected by changes in interest rates, while corporate bonds are more affected by the company's profitability.

Various types of bond can be issued. These include inflation-linked bonds, where payments are linked to changes in inflation, and convertible bonds, which are corporate bonds that can be converted into the company's underlying equity (shares). Certain types of bonds may be better suited to particular economic conditions, or meeting particular investment objectives.

Inefficiencies in the bond market create the potential to make additional returns in a particular bond or sector depending on the macroeconomic backdrop. By carefully researching the issuers in the market, as well as considering economic and technical factors, bond fund managers aim to manage portfolios of bonds that suit the current investment conditions.

The performance of a bond fund manager is typically measured against an index of bonds in the region or type of issuer in which they invest. This is known as a 'benchmark', which the fund manager will aim to outperform.

At a glance

✓ Bonds represent debt securities issued by companies and governments

✓ Investors can benefit through a steady stream of returns

✓ However, this is affected by interest rates, inflation and the issuers' ability to repay their debts

✓ Bonds are generally lower risk and less volatile than equities

✓ Bonds can be a source of diversification in investment portfolios, helping to reduce volatility and overall risk.

By speaking to a financial adviser, you can discuss whether such an investment may be right for you.

Glossary

Benchmark: A standard against which a fund's performance can be measured. A benchmark is often called an index.

Commercial property: Any property used for commercial purposes. Commercial property has three main sectors: retail, office and industrial. It excludes residential property.

Convertible bonds: Convertible bonds allow their owners to convert their holdings into a pre-determined number of the company's shares.

Coupon: A regular interest payment that is paid on a bond.

Credit rating: A score assigned to a bond issue or a borrower, based on their creditworthiness. It may apply to a government or company, or to one of their individual debts or financial obligations.

Equity: A security representing ownership, typically listed on a stock exchange. To have 'equity' in a company means to hold shares in that company and therefore have part ownership.

Inflation: The rate at which the prices of goods and services are rising in an economy. The CPI and RPI are two common measures. The opposite of deflation.

Inflation-linked bonds: Bonds where the coupon and principal payments are adjusted in line with the rate of inflation; for example, Treasury inflation-protected securities (TIPS) issued by the US government. Inflation-linked bonds are also known as index-linked bonds, or 'linkers'.

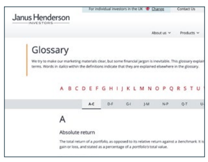
Outperform: To deliver a return greater than that of a fund's assigned benchmark.

Maturity: the date when the issuer of a bond must repay the principal amount and any interest to the holder of the bond. Maturity date is set when the bond is first issued, but the bondholder can sell anytime before this date. Bonds can be short-term, medium-term or long-term, referring to the length of maturity.

Principal: The amount originally loaned on a bond, which must be paid back.

Volatility: The rate and extent at which the price of a fund, security or index, moves up and down. If the price swings up and down with large movements, it has high volatility. If the price moves more slowly and to a lesser extent, it has lower volatility. It is used as a measure of the riskiness of an investment.

Yield: The level of income on a security, typically expressed as a percentage rate.



Glossary: Please see HGi.co/glossary for a glossary of financial terms used in this document.

FOR MORE INFORMATION, PLEASE VISIT **JANUSHENDERSON.COM**

Janus Henderson
INVESTORS

Important information

The views presented are as of the date published. They are for information purposes only and should not be used or construed as investment, legal or tax advice or as an offer to sell, a solicitation of an offer to buy, or a recommendation to buy, sell or hold any security, investment strategy or market sector. Nothing in this material shall be deemed to be a direct or indirect provision of investment management services specific to any client requirements. Opinions and examples are meant as an illustration of broader themes, are not an indication of trading intent, are subject to change and may not reflect the views of others in the organization. It is not intended to indicate or imply that any illustration/example mentioned is now or was ever held in any portfolio. No forecasts can be guaranteed and there is no guarantee that the information supplied is complete or timely, nor are there any warranties with regard to the results obtained from its use. Janus Henderson Investors is the source of data unless otherwise indicated, and has reasonable belief to rely on information and data sourced from third parties. **Past performance does not predict future returns. Investing involves risk, including the possible loss of principal and fluctuation of value.**

Not all products or services are available in all jurisdictions. This material or information contained in it may be restricted by law, may not be reproduced or referred to without express written permission or used in any jurisdiction or circumstance in which its use would be unlawful. Janus Henderson is not responsible for any unlawful distribution of this material to any third parties, in whole or in part. The contents of this material have not been approved or endorsed by any regulatory agency.

Janus Henderson Investors is the name under which investment products and services are provided by the entities identified in the following jurisdictions: (a) Europe by Janus Capital International Limited (reg no. 3594615), Henderson Global Investors Limited (reg. no. 906355), Henderson Investment Funds Limited (reg. no. 2678531), Henderson Equity Partners Limited (reg. no.2606646), (each registered in England and Wales at 201 Bishopsgate, London EC2M 3AE and regulated by the Financial Conduct Authority) and Henderson Management S.A. (reg no. B22848 at 2 Rue de Bitbourg, L-1273, Luxembourg and regulated by the Commission de Surveillance du Secteur Financier).

GC-0222-117841 06-30-23 200-99-117841 02-22