Bonds (Part II)

Speaker: Mr. Alex Lee

Date: 6 September (Friday)

Time: 4:30pm - 5:30pm

What would affect bond prices?

- **Credit rating** – is an evaluation of the credit risk of a prospective debtor (corporations, local governments, central governments), predicting their ability to pay back the debt and an implicit forecast of the likelihood of defaulting.

- **3 Major Credit Rating Agencies**
  - Standard & Poor
  - Moody
  - Fitch
  - Corporations have to request & pay for them to grant ratings

Moody's		Standard & Poor's		Fitch Ratings		Rating description	EU Credit Quality Step[18][19][20]	Long run benchmark default rates (mid value)[21]	Short run benchmark default rates (trigger level)[21]
Long-term	Short-term	Long-term	Short-term	Long-term	Short-term				
Aaa	P-1	AAA	A-1+	AAA	F1+	Prime	1	0.1%	1.2%
Aa1		AA+		AA+		High grade			
Aa2		AA		AA		High grade			
Aa3		AA−		AA−		High grade			
A1		A+	A-1	A+	F1	Upper medium grade	2	0.25%	1.3%
A2		A		A		Upper medium grade			
A3	P-2	A−	A-2	A−	F2	Upper medium grade			
Baa1		BBB+		BBB+		Lower medium grade	3	1.0%	3.0%
Baa2	P-3	BBB		BBB	F3	Lower medium grade			
Baa3		BBB−	A-3	BBB−		Lower medium grade			
Ba1	Not Prime	BB+	B	BB+	B	Non-investment grade speculative	4	7.5%	12.4%
Ba2		BB		BB		Non-investment grade speculative			
Ba3		BB−		BB−		Non-investment grade speculative			
B1		B+		B+		Highly speculative	5	20%	35%
B2		B		B		Highly speculative			
B3		B−		B−		Highly speculative			
Caa1		CCC+	C	CCC+	C	Substantial risks			
Caa2		CCC		CCC		Substantial risks			
Caa3		CCC−		CCC−		Substantial risks			
Ca		CC		CC		Extremely speculative	6	34%	not applicable
Ca		C		C		Default imminent			
C		RD	D	DDD	D	In default			
/		SD		DD		In default			
/		D		D		In default			

3 Main Type of Credit Rating

1. Sovereign Credit Rating – rating of a national government
   - US Treasury is not rated, considered the safest and never be defaulted.

2. Short and long term ratings (duration risk) – rating the likelihood that the debtor might default within a certain time frame.
   - he longer the time frame, the bigger the risk given the same debtor. (e.g.) 2% interest rate ↑, 30 years bond price ↓40%
   - Inverted yield curve – indication of coming recession. Investors tend not to keep long because of greater risk.

3 Main Type of Credit Rating (cont.)

3. Corporate Credit Ratings
   - It can rate the bonds themselves issued by the corporation or rating the corporation as a whole entity.
   - Balance sheet is more important than P&L statement
   - Guaranteed by parent company
   - Specific asset backing – what types of asset - tangible or non-tangible - business, land, properties, patents etc. Best assets should be liquid & easy to sell to recover cash
   - Subordinated note – usually without asset pledged, lower credit ranking.

Spread Risk

- Difference of yields spread along a yield curve between bonds of different credit ratings.
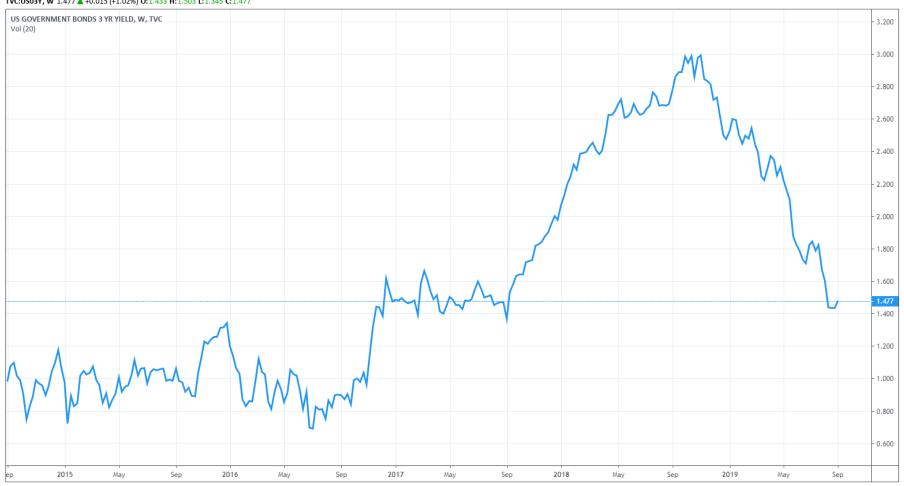 - e.g.   AA vs BB   AA vs CCC

- During the bull market of bond investment, the spreads between high grade and low grade bonds are relatively narrow, e.g. high yield bonds pay 4% more than the U.S. Treasury over the same duration. But during bear market (2015), the spread can be widened to 7% between the category of bonds.

- Treasury – Only interest rate risk, no credit risk. Used as reference point to gauge spreads

- Investment Grade Corporates - some credit risk, some interest rate risk

- High Yield Corporates – Most are credit risk (they behave like stocks)

Liquidity

- Most of bonds are traded over the counter.

- No central clearing system.

- More dealers or market makers participate the better, more competition, better pricing, more liquid.

- Chinese bonds issued being included into main bond index in the global market. Global bond funds, ETF have to own weighted position of Chinese bonds. As a result, more trading and better liquidity.
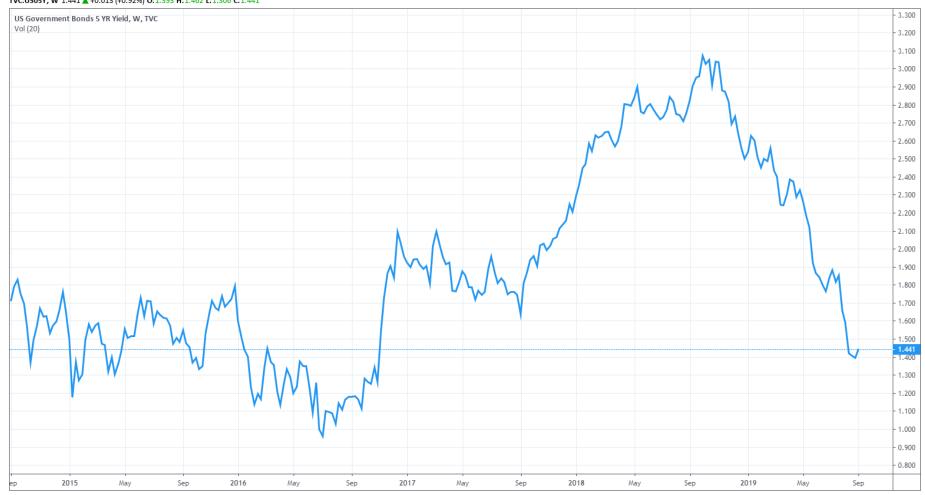
US3Y

TVC:US03Y, W 1.477 ▲ +0.015 (+1.02%) **O:**1.433 **H:**1.503 **L:**1.345 **C:**1.477

US GOVERNMENT BONDS 3 YR YIELD, W, TVC
Vol (20)

US5Y

US Government Bonds 5 YR Yield, W, TVC
Vol (20)

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US10Y

Published on TradingView.com, September 06, 2019 04:02:42 UTC
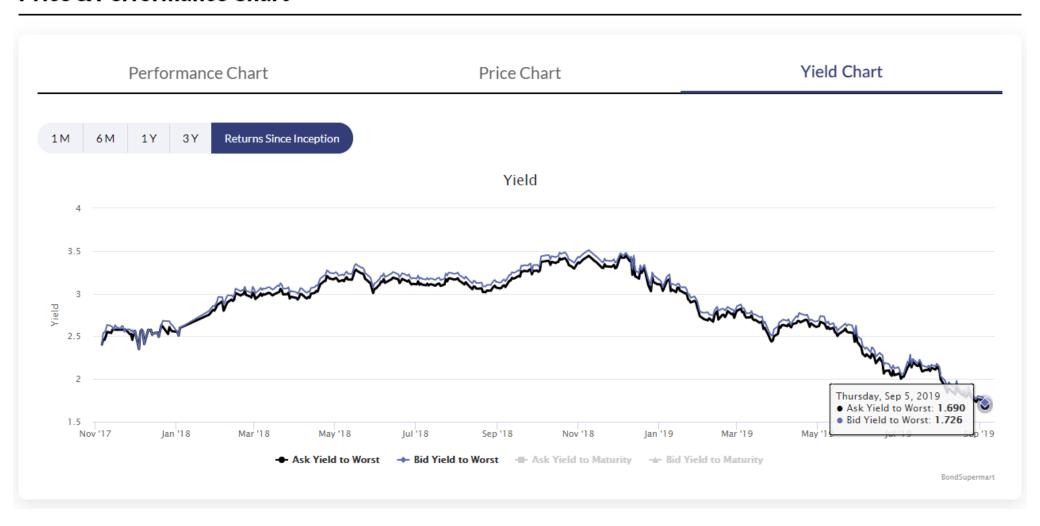TVC:US10Y, W 1.577 ▲ +0.012 (+0.76%) O:1.509 H:1.580 L:1.428 C:1.577

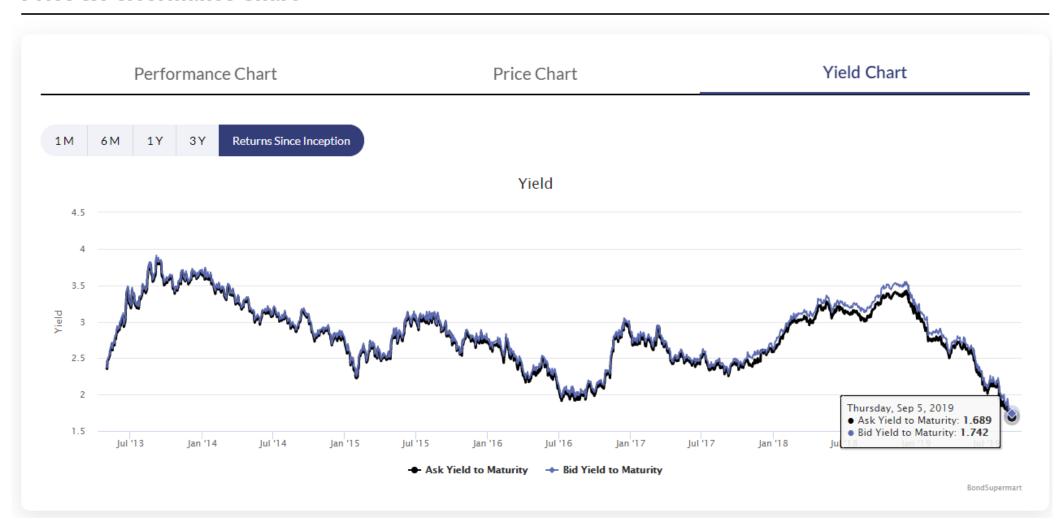US Government Bonds 10 YR Yield, W, TVC
Vol (20)

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US30Y

AAPL 2.400% 13Jan2023 (5y) AA+

Price & Performance Chart

Performance Chart	Price Chart	**Yield Chart**

1 M 6 M 1 Y 3 Y **Returns Since Inception**

Yield

Thursday, Sep 5, 2019
● Ask Yield to Worst: **1.690**
● Bid Yield to Worst: **1.726**

◆ Ask Yield to Worst ◆ Bid Yield to Worst ⊞ Ask Yield to Maturity ✦ Bid Yield to Maturity

AAPL 2.400% 03May2023 (10y) AA+

Price & Performance Chart

GS 2.557% 12Nov2020 (5y) BBB+

SUNCHN 8.500% 27Sep2020 (5Y) CCC+ (2608.HK)

Price & Performance Chart

| Performance Chart | Price Chart | Yield Chart |

1M 6M 1Y 3Y Returns Since Inception

Yield

— Ask Yield to Worst — Bid Yield to Worst — Ask Yield to Maturity — Bid Yield to Maturity

BondSupermart