What are Bonds?

Bonds are financial instruments categorized as fixed-income securities. They are a loan extended by an issuer to a borrower. By lending funds to the bond's issuer, the investor anticipates receiving regular interest payments and the eventual return of the bond's face value upon maturity. Corporations and governments commonly utilize bond issuances to fulfill various objectives, including project financing and short-term liquidity management. Fundamentally distinct from equities, bonds use unique terminology, including: par value, coupon rate, term to maturity, yield to maturity, and credit rating.

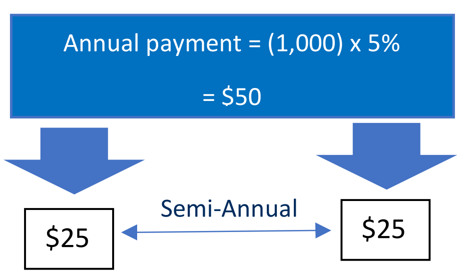
Par or Face Value

Initially, the majority of bonds are issued at their par value ($100), in units of 1000. However, as they trade in the secondary market, their prices can fluctuate. If a bond is trading below its par value, it is considered to be at a **discount**, whereas if it is trading above par value, it is considered to be at a **premium**. Regardless of these fluctuations, the bond will always be redeemed at its original par value, barring insolvency of the issuer.

Coupon rate

This is the annual interest rate paid to the bondholder as compensation for the loan. Typically, interest is disbursed semi-annually, resulting in coupon payments equivalent to half of the coupon rate.

Example: $1,000 bond, coupon 5%, semi-annual pay



Term to maturity

Remaining length of time until a bond reaches its **maturity date**.

Yield to maturity (YTM)

Anticipated return that an investor is expected to receive if they hold a bond until maturity. YTM calculations consider the bond's **coupon rate**, **purchase price**, and **par value**. When the purchase price is **below par**, the yield will exceed the bond's coupon rate. Conversely, if the purchase price is **above par**, the bond's yield will be lower than the coupon rate.

Credit rating

Credit ratings help investors assess the quality and creditworthiness of a bond as they capture opinions on the financial strength of the issuer. These are assigned by independent credit rating agencies, including Standard & Poor's (S&P) and Moody's. A **lower credit rating** indicates a **higher risk** of default or inability to make regular interest payments. Additionally, at issuance, a bond's **coupon rate** is influenced by its credit quality; the lower the quality, the more interest investors will demand to compensate for the associated risk.

Moody's	S&P	Grade	Perceived Risk
Aaa	AAA	Investment	Lowest
Aa1 Aa2 Aa3	AA+ AA AA-	Investment	Low
A1 A2 A3	A+ A A-	Investment	Lower-medium
Baa1 Baa2 Baa3	BBB+ BBB BBB-	Investment	Medium
Ba or lower	BB or lower	High Yield	High