

OUTLOOK FOR GLOBAL BOND MARKETS

US INVESTMENT GRADE

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What are Bonds?

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Bonds 101: What are bonds and why do they exist

- A bond is a debt security, similar to an **I.O.U.**
- When you purchase a bond, you are lending money to a an *issuer*.
- In return for that money, the issuer provides you with a promise to pay a specified rate of *interest* during the life of the bond and to repay the *principal* when it comes due.
- Even bigger than the stock market, the largest securities market in the world plays a vast and vital role on the global stage and the U.S. economy.

Features

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Coupon:

A feature of a bond that denotes the amount of interest due, and the date payment will be made.

Maturity:

The date when the principal amount of a security is due to be repaid.

Rating:

Designations used by credit rating agencies to give relative indications as to opinions of credit quality.

Risks

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- All investments carry some degree of risk, which is linked to the return that investment will provide.

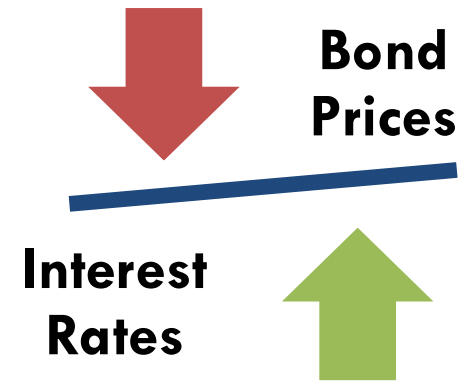
- A good rule of thumb is the higher the risk, the higher the return.

- Two types of Risk related to fixed income:
 - **Interest Rate Risk**
 - **Credit Risk**

Interest Rate Risk

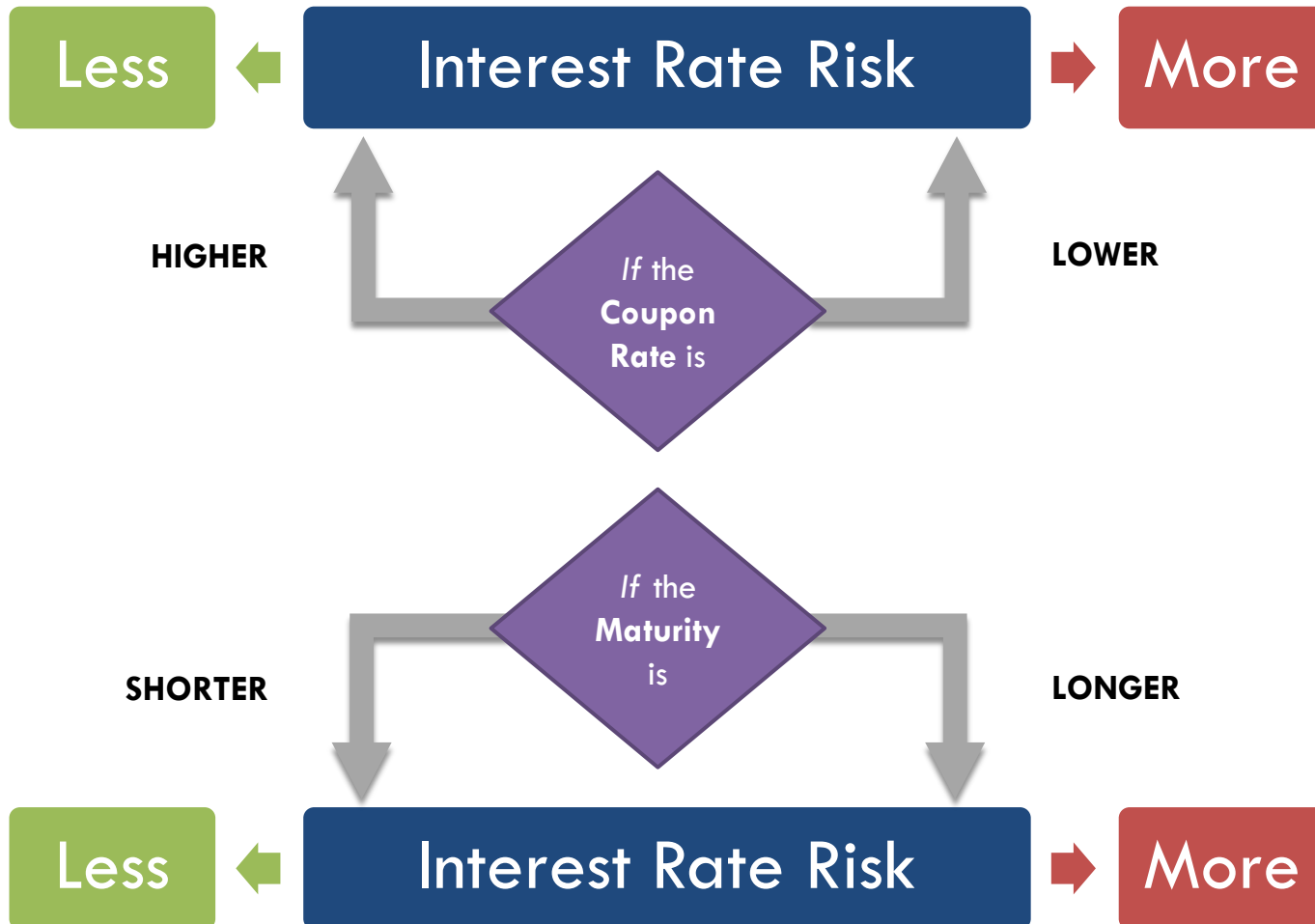
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- The risk that an **investment's value** will change due to a change in the **level of interest rates**.
- As interest rates **rise**, bond prices **fall** and vice versa.
- How much interest rate risk a bond has depends on how **sensitive** its price is to interest rate changes in the market.
- The sensitivity depends on two things, the bond's time to **maturity** and the **coupon** rate of the bond.



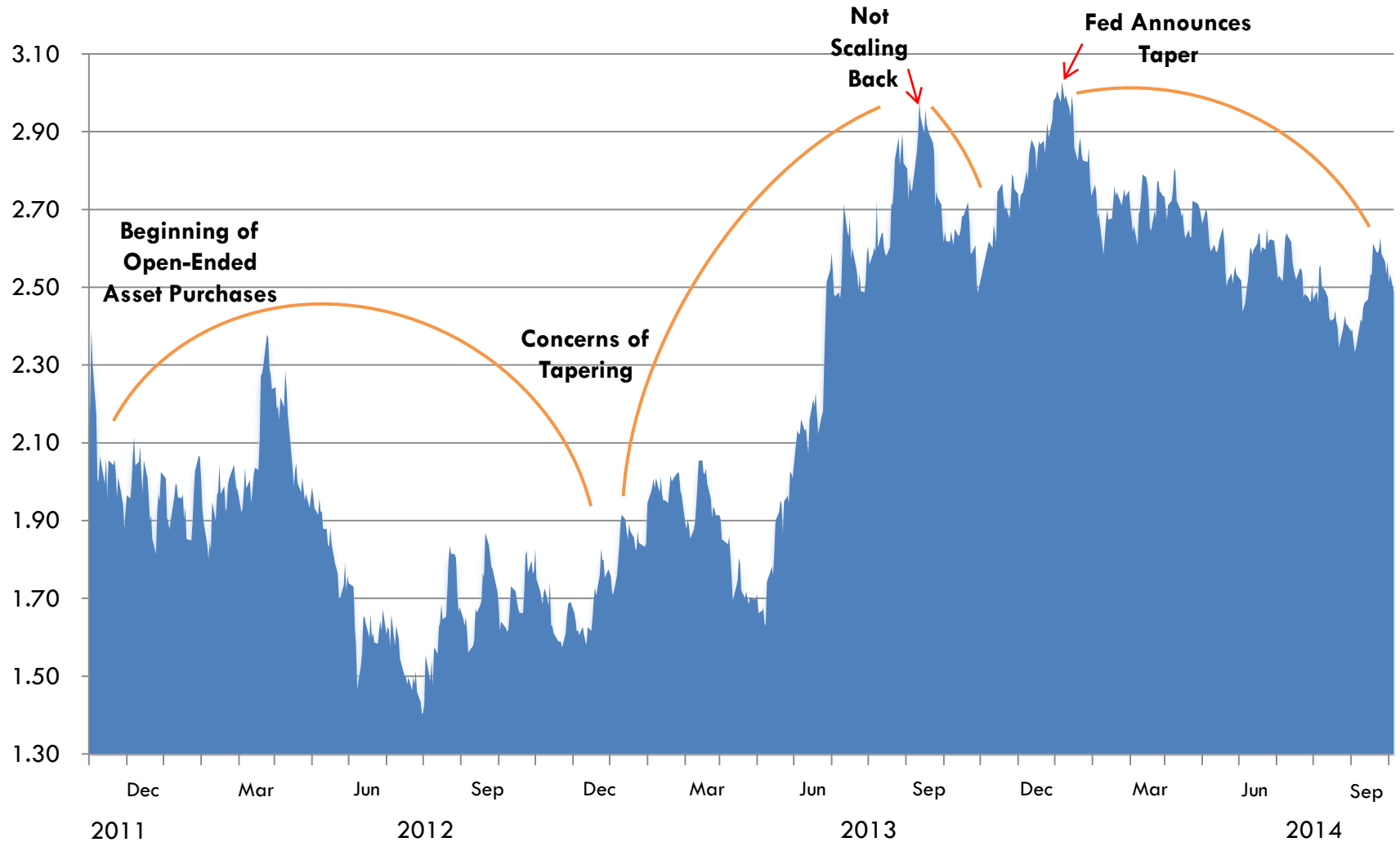
Interest Rate Risk

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Graph of 10-Year Treasury Yield

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Credit Risk

- The risk that a borrower will default on any type of debt by failing to make payments which it is obligated to do.
 - Loss of principal or interest payments or any disruption of cash flows.
 - Loss may be complete or partial.

- Ratings agencies such as S&P, Moody's, and Fitch evaluate the credit risks of thousands of bond issuers on an ongoing basis.

- Credit risks are estimated by the borrower's overall ability and willingness to repay their debts.

- The higher the perceived credit risk, the higher the rate of interest that investors will demand.

Credit Risk

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Why quality matters...

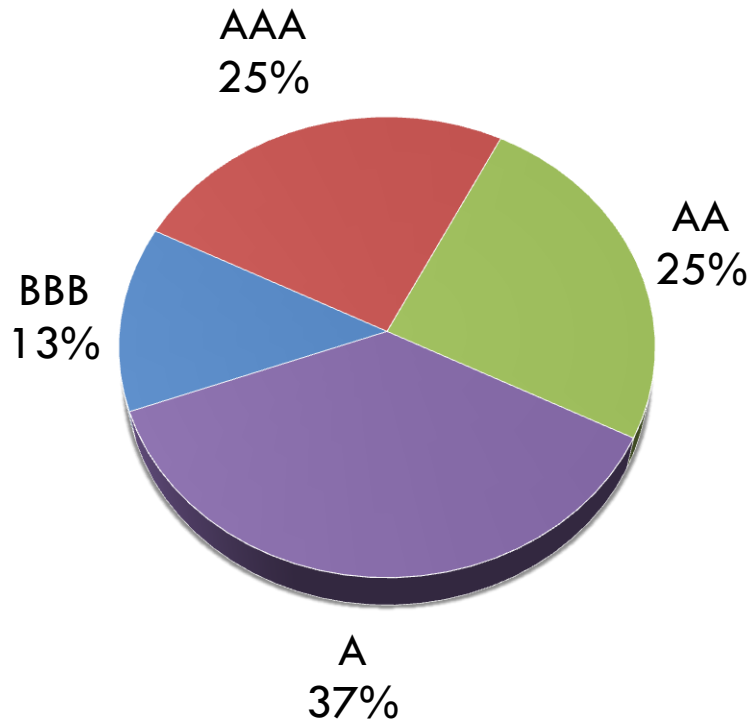
- ❑ Debt ratings are an assessment of the creditworthiness of the issuer.
- ❑ An important thing to recognize about a bond's yield is that it is calculated assuming that all the promised payments will be made.
- ❑ As a result, it is really a promised yield, and it may or may not be what you will earn.
- ❑ If the issuer defaults, your actual yield will be much lower.



Corporate Credit Quality Distribution

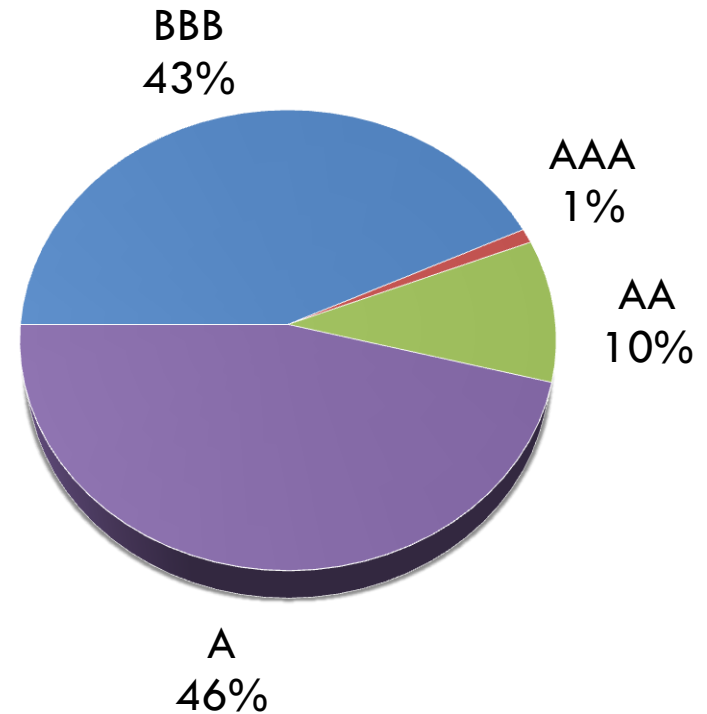
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1980



\$178 Billion

Today



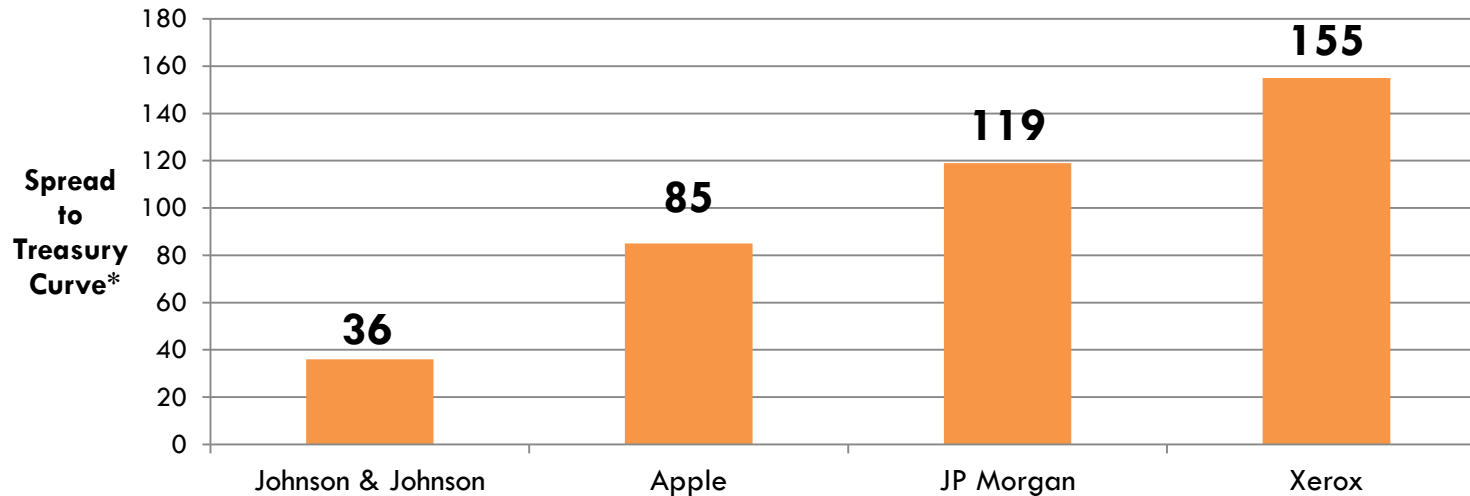
\$4.0 Trillion

Source: Bloomberg, BarCap Live
Chart data is as of 12/31/1980 & 9/30/2014

Credit Risk

Ratings	Examples	% of Index*
AAA	Johnson & Johnson, Microsoft, Exxon Mobil	1.00%
AA	Apple, Wal-Mart, IBM, Chevron	9.60%
A	JP Morgan, Wells Fargo, AT&T, Pepsi, Target	46.20%
BBB	Xerox, Capital One, Raymond James, Waste Management	43.30%

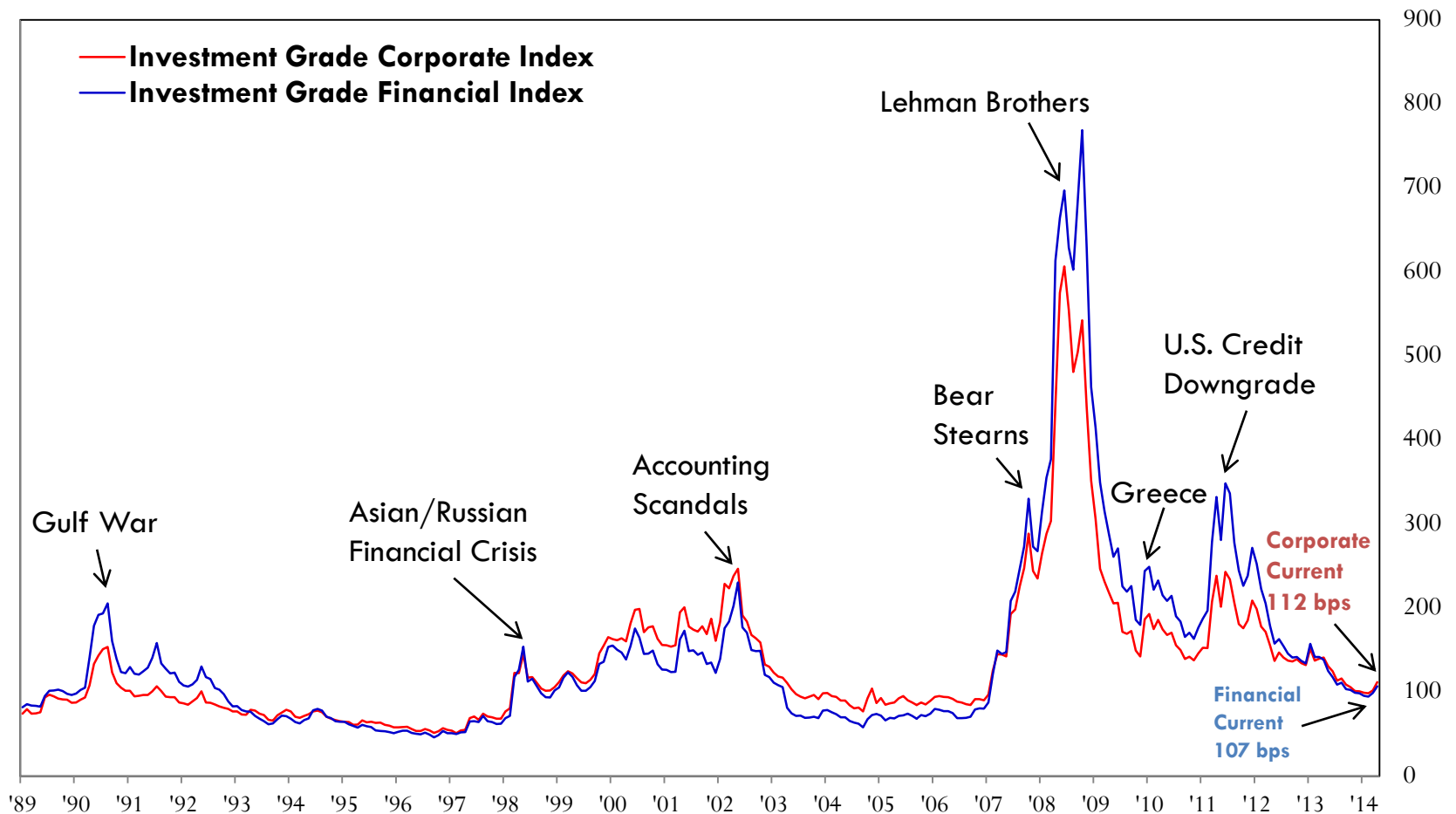
*Percentage of Barclays Capital Investment Grade Corporate Index



*Ten Year Corporate Bond Yield minus Interpolated Government Yield.

Average Option Adjusted Spreads (OAS)

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Conclusion

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- Low Yield Environment
- Limited Opportunity in Corporate Bond Spreads
- Evaluate the interest rate risk and credit risk in your fixed income portfolios