Bonds

Rory Gwozdz
Bonds Broadly

Essentially, a loan taken out from investors
Higher on the Capital Structure

The global bond market is about three times the global equity market

Bonds are legal contracts
“Bound to this”

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Bonds - Maturity

Overview of Characteristics of a Bond

Maturity - time until principal’s paid back
  Indicates Expected Life and Amount of Payments
  Dictates yield courtesy of the curve
  Affects Duration and Interest rate risk

Call Privilege - Issuer can call the debt back from owners
  Why might this happen? Why would a company care?

Sinking Issuances, Serial Issuances
Bonds - Coupon and Principal

Overview of Characteristics of a Bond

Principal - Face, Par value of a bond
  Typically $1000 Increments
  Typically Semiannual
  Except MBS and ABS (which are Monthly)
  Most European and all Eurobonds are annual

Coupons - Now, Registered Issues (Old, Bearer Bonds)
  Paid at a certain time, on schedule
  Zero coupon, Step up, Floating, are all alternative
  Inflation Linked Securities (i.e. TIPS)
  Linked to CPI - Urban Index
Bonds

Four Types, Dependent on Issuer

Treasuries - treasury.gov
Municipal - emma.msrb.org
Sovereign - bloomberg.com
Corporate - fixedincome.fidelity.com
Treasuries

- **Issuer:** United States Government
- Considered the “Risk Free” rate of money
- If you need to move a billion dollars…
  - Illiquidity premium
  - On the run/off the run

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Municipals

Issuer: Cities and States

Official Statements

Tax-Exempt

- State/National

Two Types:

- General Obligation

- Revenue

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Sovereign
Issuer: Foreign Governments
Allows for higher yield
- Comparable Risk to US
Grants currency exposure

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Corporate
Issuer: Companies
Used to garner higher yields from fixed income
Most diverse in terms of credit quality
Backed by company’s credit
Tons of varying structures, maturities, rates, etc.
Bonds - Residential Mortgage Backed Securities

Two main types of RMBS:

1.) Agency Based
   a.) Issued by Freddie Mac, Ginnie Mae
   b.) AAA, full faith and credit of USA
   c.) Structure = Mortgage Pass Through, CMO, Stripped MBS (Principal and Interest)

2.) Non Agency Based
   a.) Thrift Banks, Private Banks
   b.) Vary from Prime to Subprime
   c.) Only ever CMO

3.) Prepayment Risk
   a.) Risk that interest rates fall and homeowners payback early, refinancing.
      i.) Essentially, risk of being called.

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**Bonds - in Private Equity**

Why Bonds even matter in Private Equity:

1.) The leverage of a leveraged buyout might have to be financed with bond issuance.

2.) A company might have outstanding debt that they need to avoid.

3.) A Firm might want to avoid paying interest right at the beginning of the company’s takeover.

With LBO’s, a company might defer having interest burdens via:

1.) Deferred interest Bonds (pay later)
2.) Step Up Bonds (pay more later)
3.) Payment in Kind, PIK (pay much more later)
Bonds - Better than Equity?

For young investors, no, probably not.

- Great for income if that’s what you’re looking for.
- Great as a temporary holding in portfolio.
- Bond ETF’s bring risk basis down.
- But no Growth, compared to equities.
  - Cool plays in distressed debt.

For middle aged investors, an allocation is appropriate.

- Helps diversify away risk
- Still prime time for equities

For older investors, fixed income is essential.

- Grants passive income for retirement.

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Bonds - Miscellaneous

Understanding bonds leads to understanding:

- Asset Backed Securities
  - CMBS/MBS
  - Banks Broadly
  - Insurance and Banks
    - Cat Bonds and ILS
- Convertible Equity and Debt
- Arbitrage/Distressed Debt Strategies
  - Capital Structure
  - Leverage
Questions?
Bonds - Time Permitting

Price and Interest Rates
  - Why that’s a thing

Bankruptcy
  - Debt Perspective

DIP financing
  - Why that’s a thing too