

# Bonds 101

# What is a Bond?

- A bond is a loan made to a government or corporation
- When a government or a corporation borrows money it is for a certain period of time at a certain rate of interest

# SMG Bonds

- SMG will offer the following types of bonds:
  - **Corporate**
  - **Government & Agency**
  - **Municipal**

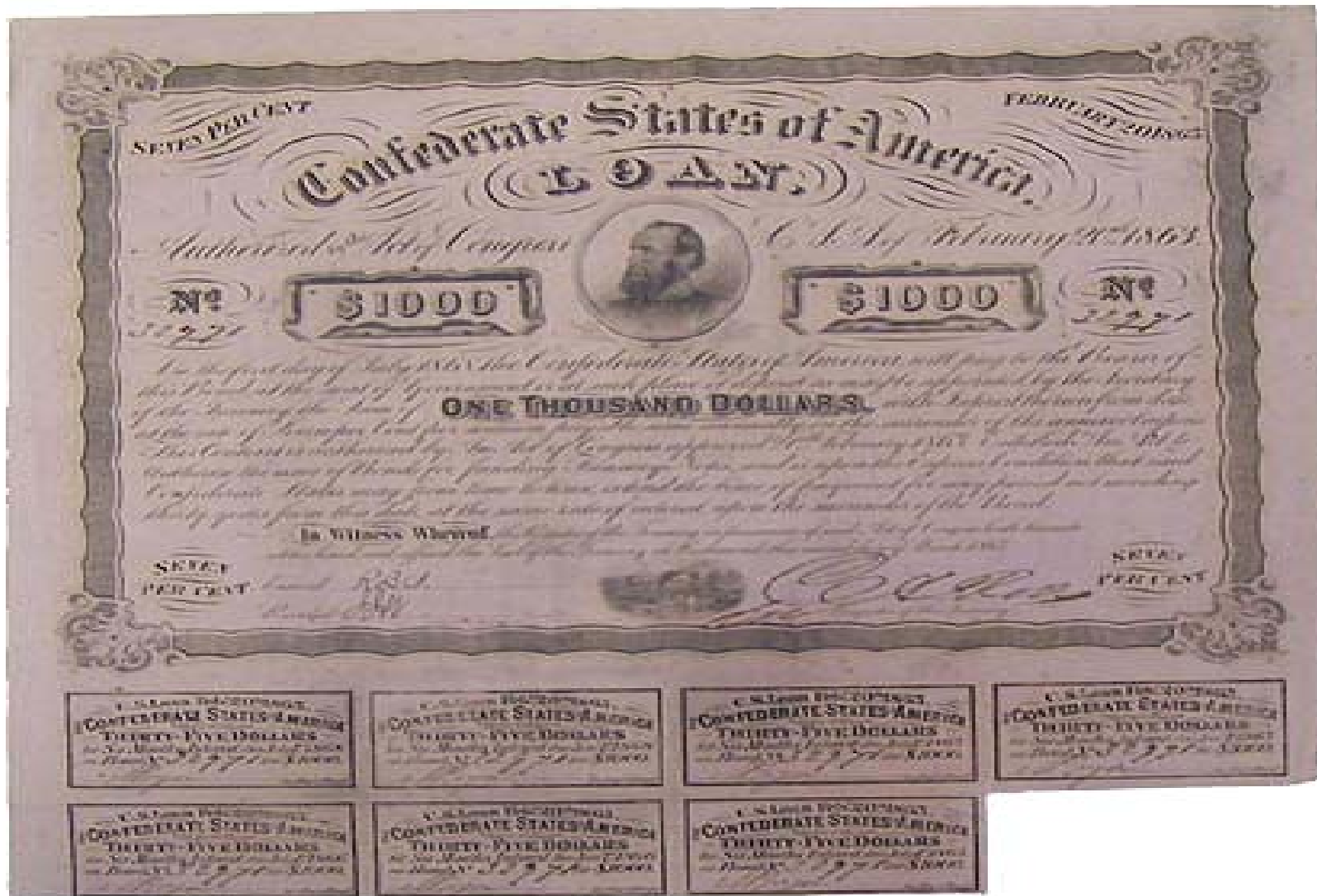
# SMG Bond Elements

- Corporates and Municipals are purchased in \$1,000 increments
- Treasuries are available in \$100 increments
- Maturity is the length of time the money is loaned
- SMG Bonds will have maturities no shorter than five years

# Elements Continued

- The maturity date is the date the original principal borrowed with the bond comes due
- SMG bond maturity dates are in the ticker symbol
- SMG Bonds have a stated rate of interest (a.k.a. coupon rate)
- Credit quality and maturity determine the bond's interest (coupon) rate
- Longer maturity term = higher interest rate

# Coupon Bond



# What is Investment Grade?

<u>Moody's</u>	<u>S&amp;P</u>	<u>Meaning</u>
<b>Investment Grade Bonds</b>		
Aaa	AAA	Bonds of the highest quality that offer the lowest degree of investment risk. Issuers are considered to be extremely stable and dependable.
Aa1, Aa2, Aa3	AA+, AA, AA-	Bonds are of high quality by all standards, but carry a slightly greater degree of long-term investment risk.
A1, A2, A3	A+, A, A-	Bonds with many positive investment qualities.
Baa1, Baa2, Baa3	BBB+, BBB, BBB-	Bonds of medium grade quality. Security currently appears sufficient, but may be unreliable over the long term.

# What is Non-Investment Grade?

## Non Investment Grade Bonds (Junk Bonds)

Ba1, Ba2, Ba3

BB+, BB, BB-

Bonds with speculative fundamentals. The security of future payments is only moderate.

B1, B2, B3

B+, B, B-

Bonds that are not considered to be attractive investments. Little assurance of long term payments.

Caa1, Caa2, Caa3

CCC+, CCC, CCC-

Bonds of poor quality. Issuers may be in default or are at risk of being in default.

Ca

CC

Bonds of highly speculative features. Often in default.

C

C

Lowest rated class of bonds.

-

D

In default.

# Par Value, Price and Yield

- Most bonds have a par value of \$1,000
- Bonds trade at prices slightly less than par (discount) or more than par (premium)
- Bonds pay par value at maturity
- Interest (coupon) rate is paid on par value; not the price paid for the bond
- Like price, the bond yield is slightly less or more than the interest (coupon) rate

# What Causes Bond Prices to Change?

- National or international political or economic crisis(es) 
- Natural or unnatural disaster 
- Flight to quality or flight to safety
- Peace and prosperity 

# Interest Rates



# Interest Rates and Bond Prices

Inverse Relationship:

Interest Rates



Bond Price



Bond Price



Interest Rates



# Corporate Bonds

- Major source of corporate borrowing
- Debentures, the most common corporate bonds, are backed by the general credit of the corporation.
- Typically issued in \$1,000 par value amounts

# SMG Corporate Bond Maturities

- SMG corporate bonds, generally will have the following maturities:
  - Medium-term notes/bonds: Maturities of 5–12 years
  - Long-term bonds: Maturities greater than 12 years

# Municipals Bonds

- Millions of bonds have been issued by state and local governments
  - The interest on most municipal bonds is federally tax-free and free from state taxes if issued in your state
  - Most have long-term maturities (10, 20, 30 years)

# Treasurys



- **U.S. Treasury Securities** - US Treasurys are backed by the full faith and credit of the U.S. government.
- Treasurys are not given ratings -- they are considered "bulletproof" debt instruments.

# Treasury Notes

- A government debt security with a fixed interest rate and maturities of 1, 2, 3, 5, and 7 years.
- Interest payments on the notes are made every six months until maturity.
- Interest payments are taxed only at the federal level.

# Treasury Bonds

- A government debt security with maturities of 10, 20, and 30 years.
- Treasury bonds make interest payments semi-annually
- The income that holders receive is only taxed at the federal level
- 30-Year Bond (a.k.a: the long bond)

Questions?

