



An insight into bonds

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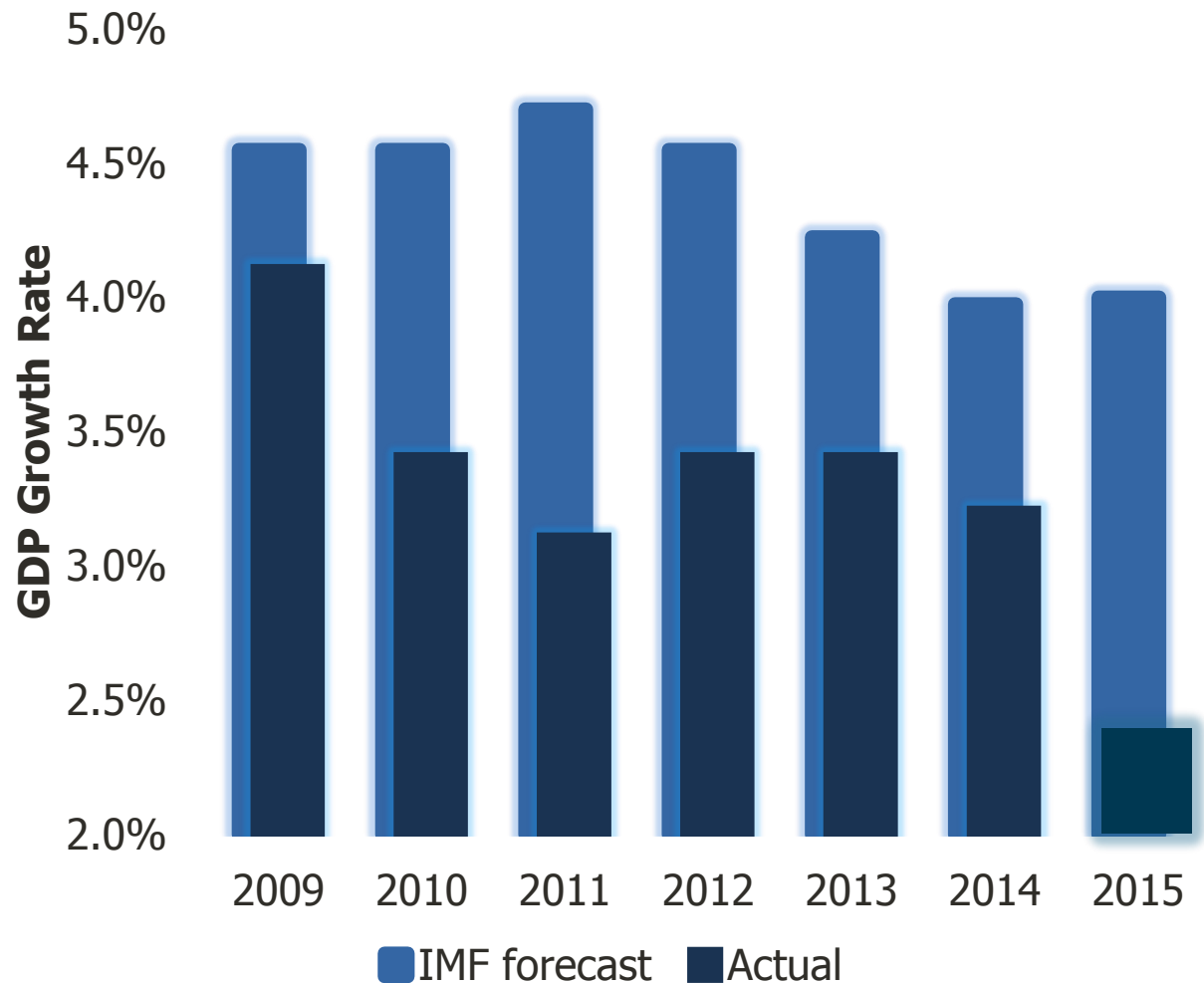
Why invest in bonds?

“The world economy continues to be beset by mediocre growth”

Christine Lagarde,
IMF MD 2016

Lower for Longer

IMF Global GDP forecasts vs Actual



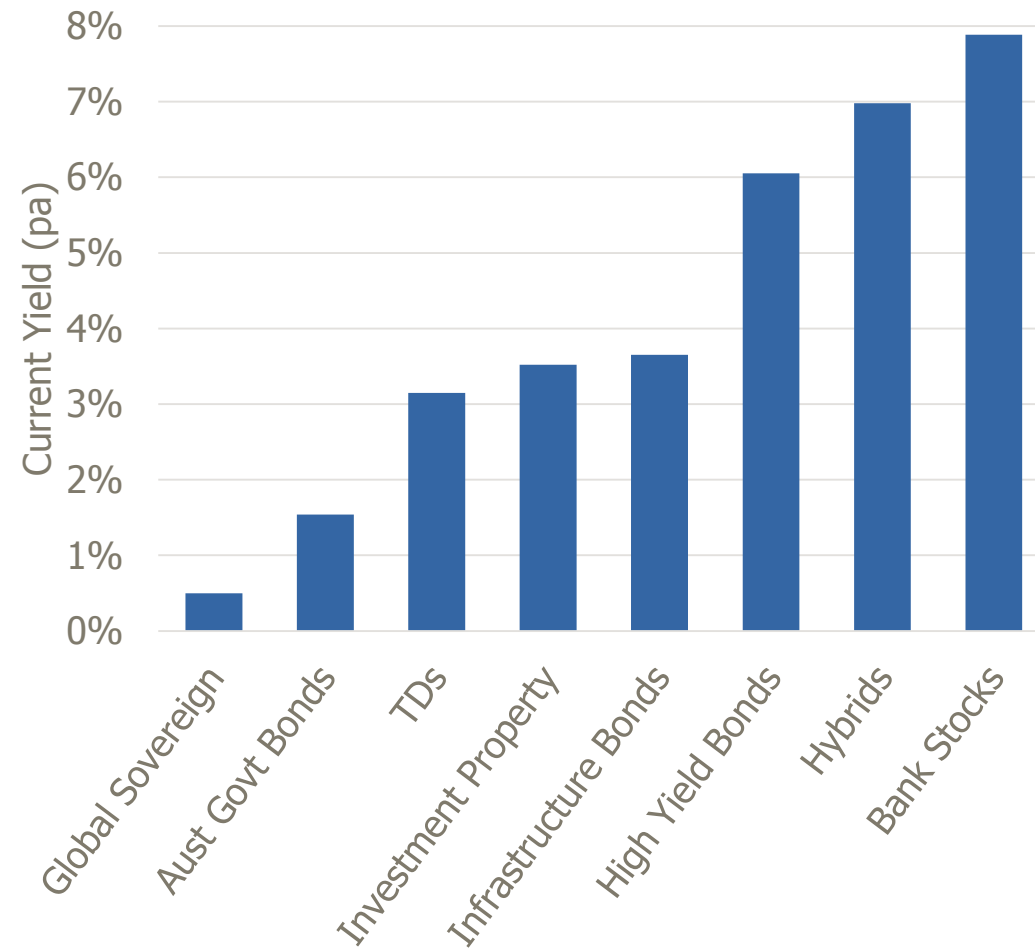
Why invest in bonds?

“Nothing is cheap out there”

JP Morgan

Income, with less risk

Various income investments for Australian investors



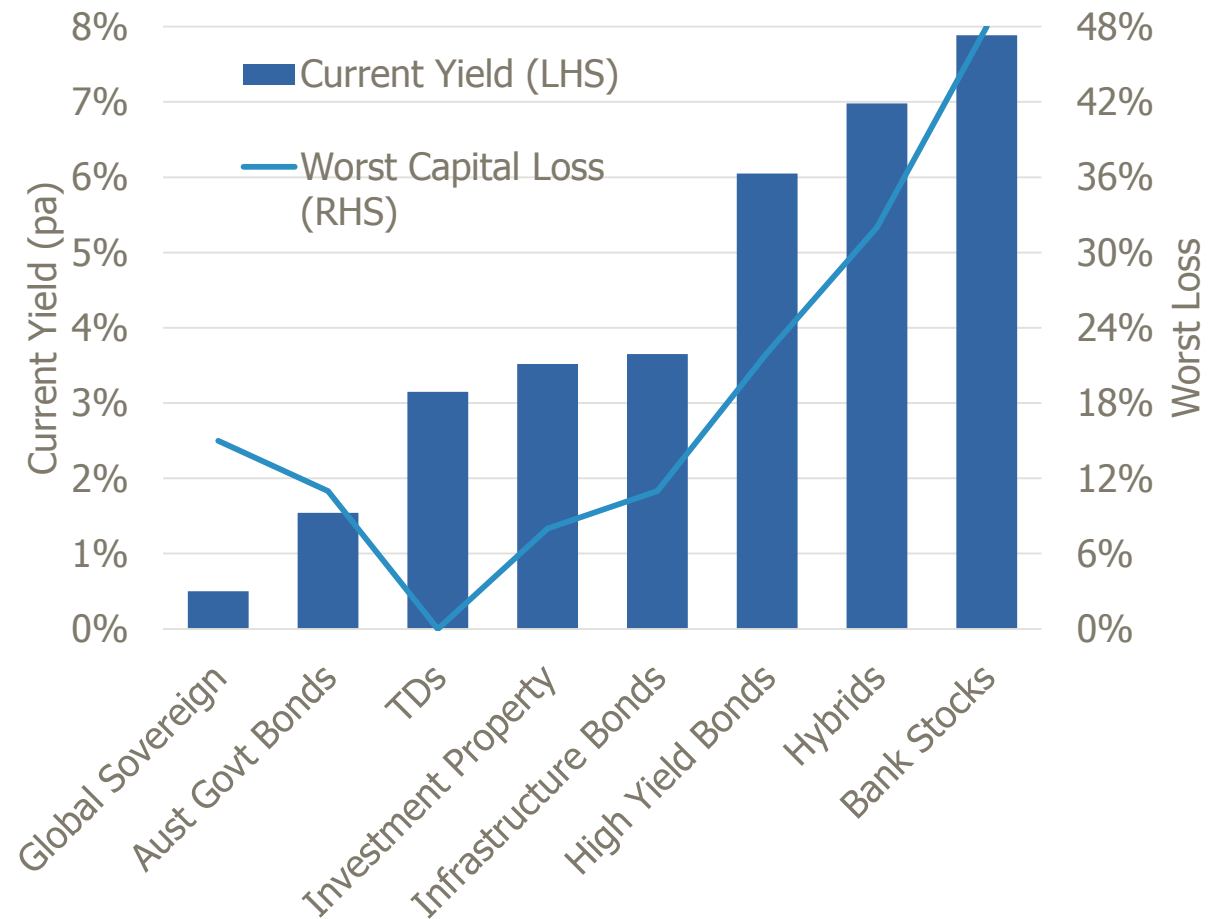
Why invest in bonds?

“An investment in knowledge pays the best interest”

Benjamin Franklin

Income, with less risk

Various income investments for Australian investors



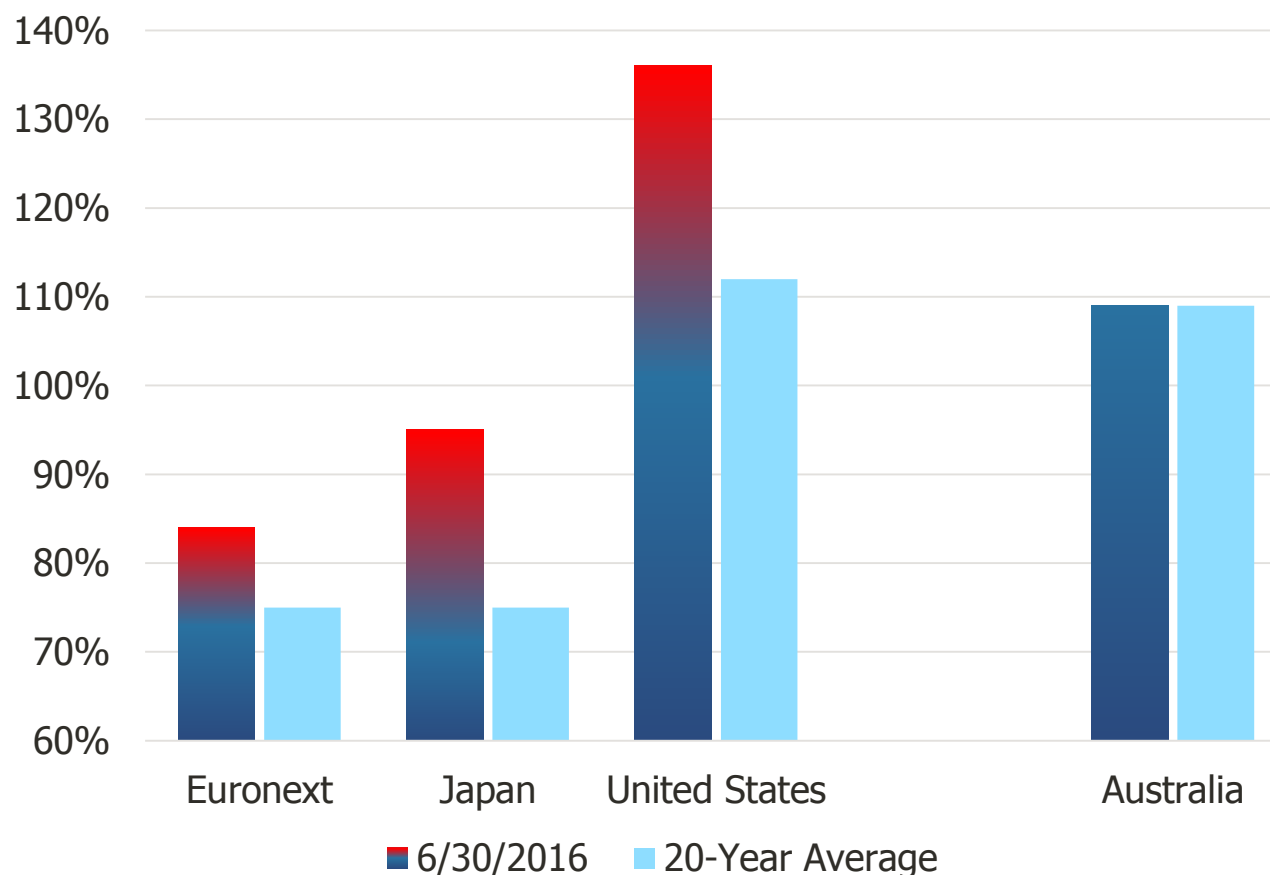
Why invest in bonds?

“Every now and then the market does something so stupid that it takes your breath away”

Jim Cramer

US, Japanese and European equities 10-30% overvalued

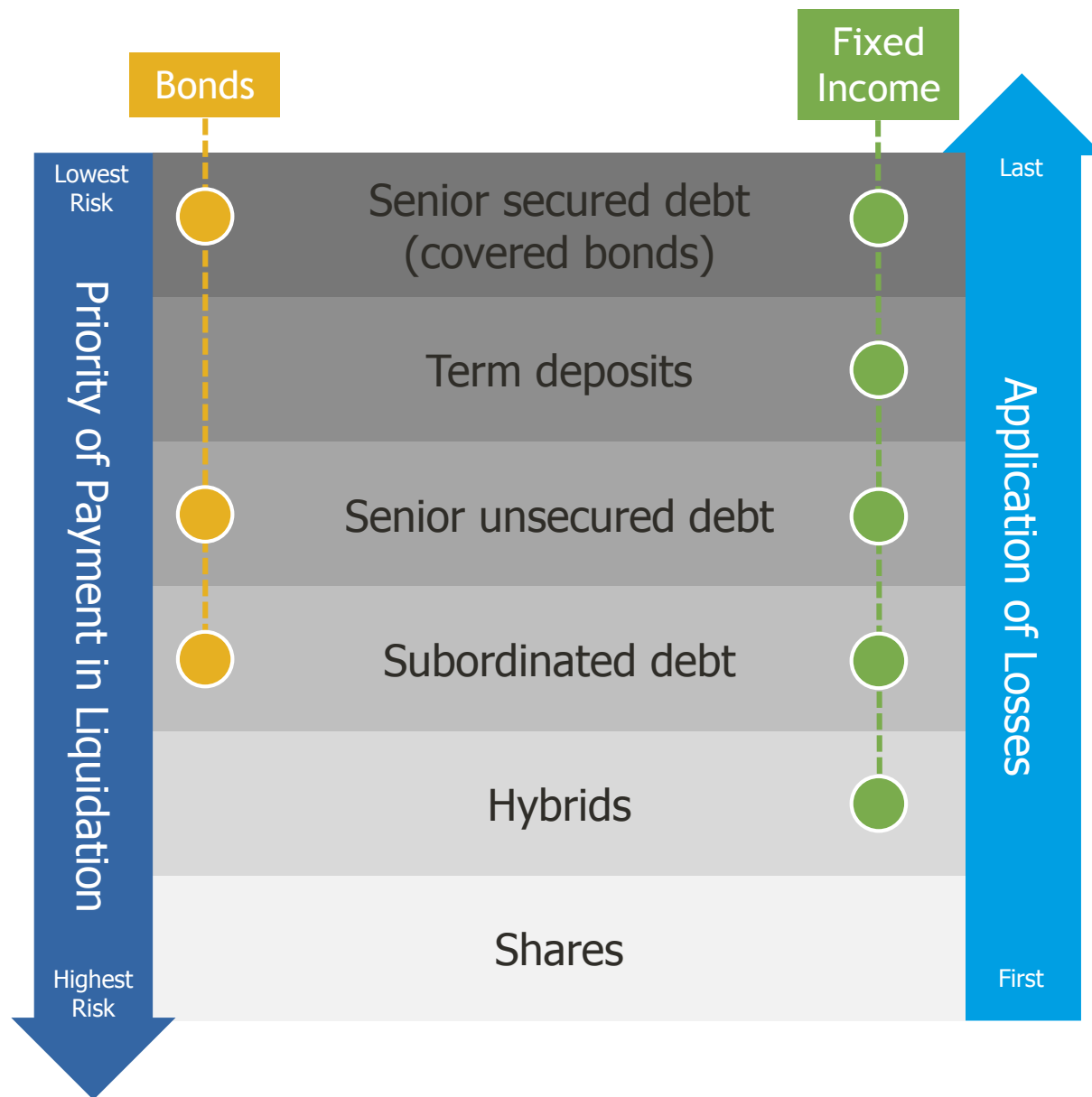
Market capitalisation to GDP ratio, Current vs 20yr avg



Capital structure explained

“Invest in substance
over form”

Warren Buffett



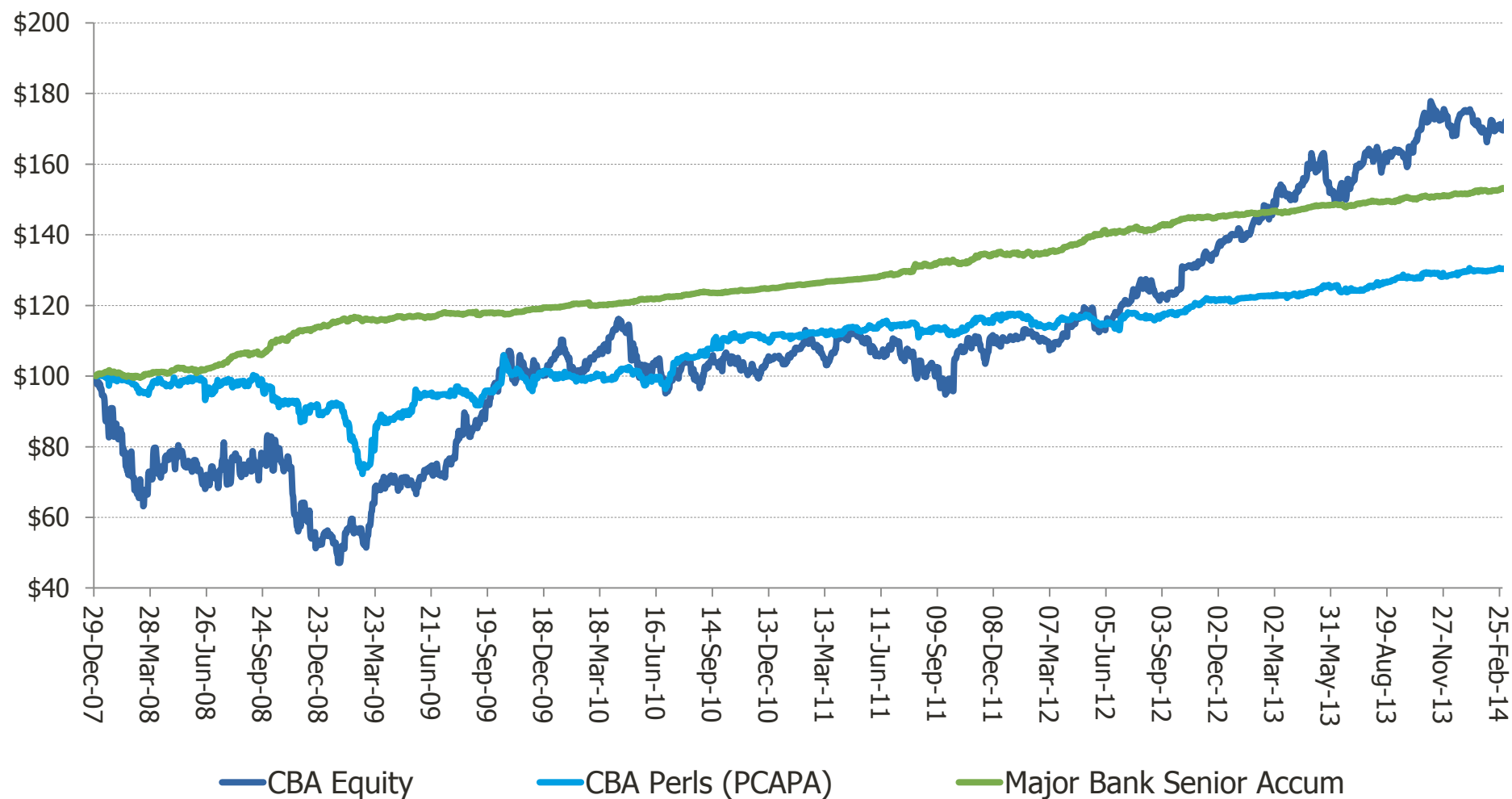
Bonds versus deposits

Bonds	VS	Deposits
Invest in a government or corporate including ADIs - known term		Invest in an ADI - known term
Set interest payment dates - quarterly or half yearly		Set interest payment dates- TDs pay at maturity
Repay principal at maturity		Repay principal at maturity
Tradeable/ liquid		Not tradeable/ illiquid
Higher returns possible		No opportunity for higher returns

How the capital structure translates in the market

CBA value of \$100 invested on 29 December 2007

(includes dividends and franking on shares and interest payments on bonds)



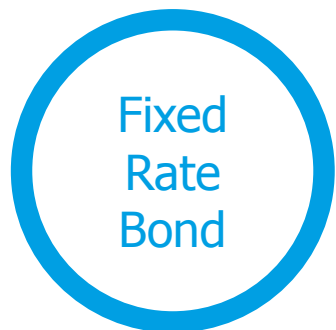
Source: FIIG Securities, Bloomberg

Bonds - quick facts

- Fact #1: Bonds are boring
- Fact #2: Massive market:
 - \$1 trillion in Australia
 - Globally, larger than equities
- Fact #3: OTC, liquid market
 - traded over-the-counter (OTC)
 - liquid, down to \$10,000 transactions
- Fact #4: capital gain or loss possible, just smaller than equities
- Fact #5: Australia at the bottom of medal tally in bonds
 - Global allocations around 40-50%, higher in retirement
 - Australian allocations lowest in the world



Three types of bonds - Fixed rate



A fixed rate bond pays a fixed return for the life of the bond and is set at the time of issue:

- Deposits pay interest
- Bonds pay coupons

Benefits

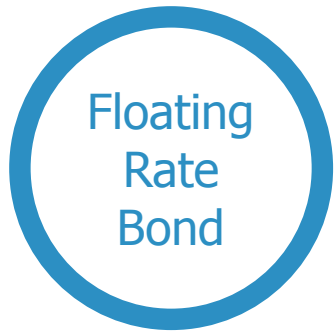
- Interest does not change
- Bonds outperform when interest rates are declining
- Bond prices rise when yields fall and prices fall when yields rise

Fixed rate bond examples

Company	Call date	Maturity date	Capital structure	Yield to maturity	Running yield	Minimum investment amount
Adani Abbot Point Terminal		01/11/18	Senior debt	8.38%	6.99%	\$200,000
Apple Inc		28/08/19	Senior debt	2.19%	2.79%	\$10,000
Newcastle Coal	31/03/27	31/03/31	Senior debt	11.40%	11.72%	USD100,000
Royal Women's Hospital	26/03/17	26/03/21	Senior debt	4.62%	6.13%	\$10,000
Westpac		11/02/20	Senior debt	2.68%	6.27%	\$100,000

*Accurate as of 4 July 2016 but subject to change
All bonds listed are available to wholesale clients only*

2. Floating rate bonds – FRNs



A floating rate bond pays income linked to a variable benchmark:

- The margin over the benchmark is fixed and set at first issue
- Income will rise and fall over time as the benchmark changes

Benefits

- Bonds outperform when interest rates are rising
- In recent times FRNs have underperformed fixed rate bonds
- Less certainty over interest payments
- Bond prices are more stable and tend to stay closer to \$100 face value

Floating rate bond examples

Company	Call date	Maturity date	Capital structure	Yield to maturity	Running yield	Minimum investment amount
Suncorp Subsidiary, AAI*	18/11/2020	18/11/2040	Sub debt	4.53%	5.14%	\$10,000
G8 Education		03/03/2018	Senior debt	6.03%	5.92%	\$10,000
NAB*	28/11/2017	28/11/2022	Sub debt	2.77%	4.11%	\$10,000

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3. Inflation linked bonds



An inflation linked bond is a security linked to the Consumer Price Index or inflation:

Two main types:

1. The capital indexed bond
2. The index annuity bond

Benefits

- These bonds are the only direct 100% hedge against inflation
- Typically very long dated, so protective over the longer term
- Bonds outperform when inflation is rising and high
- Capital indexed bonds are great for those in accumulation phase

Inflation linked bond examples

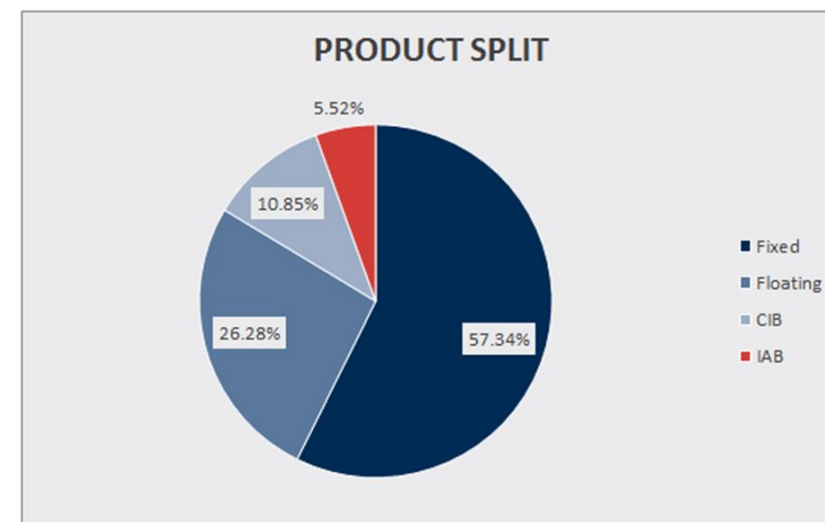
Company	Maturity date	Bond type	Capital structure	Yield to maturity	Running yield	Minimum investment amount
JEM NSW Schools	15/06/2022	Indexed annuity bond	Senior debt	4.95%	3.65%	\$50,000
Sydney Airport	20/11/2030	Capital indexed bond	Senior debt	5.72%	3.16%	\$10,000

Accurate as of 1 July 2016 but subject to change

Sample bond portfolio

Company	Yield to maturity	Running yield	Capital value
Adani Abbot Point Terminal*	8.38%	6.99%	\$193,200
Apple Inc*	2.19%	2.79%	\$102,004
G8 Education	6.03%	5.92%	\$99,500
JEM NSW Schools	4.95%	3.65%	\$92,335
National Australia Bank*	2.77%	4.11%	\$101,718
Newcastle Coal	11.40%	11.72%	\$141,943
Royal Women's Hospital Finance*	4.62%	6.13%	\$101,100
Suncorp Subsidiary, AAI*	4.53%	5.14%	\$102,965
Sydney Airport Finance	5.72%	3.16%	\$125,684
Westpac Banking Corporation*	2.68%	6.27%	\$115,587
			\$1,176,036

Portfolio exposure statistics	
Weighted average yield to maturity	5.89%
Weighted average running yield	5.90%
Weighted average trading margin	3.91%
Weighted average term to maturity	5.70
Weighted average rating #	BBB+



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FIIG originated bond

Sample cashflow

Company	3Q16	4Q16	1Q17	2Q17
Adani Abbot Point Terminal*		\$6,750		\$6,750
Apple Inc*	\$1,425		\$1,425	
G8 Education	\$1,486	\$1,504	\$1,445	\$1,375
JEM NSW Schools	\$1,870	\$1,882	\$1,893	\$1,905
National Australia Bank*	\$1,032	\$1,088	\$1,055	\$918
Newcastle Coal Infrastructure Group*	USD6,250		USD6,250	
Royal Women's Hospital Finance*	\$3,100		\$103,100	
Suncorp Subsidiary, AAI*	\$1,334	\$1,358	\$1,348	\$1,193
Sydney Airport Finance	\$992	\$998	\$1,005	\$1,011
Westpac Banking Corporation*	\$3,625		\$3,625	
	\$23,180	\$13,579	\$123,212	\$13,152

Accurate as of 4 July 2016 but subject to change
1 USD = 0.75 AUD

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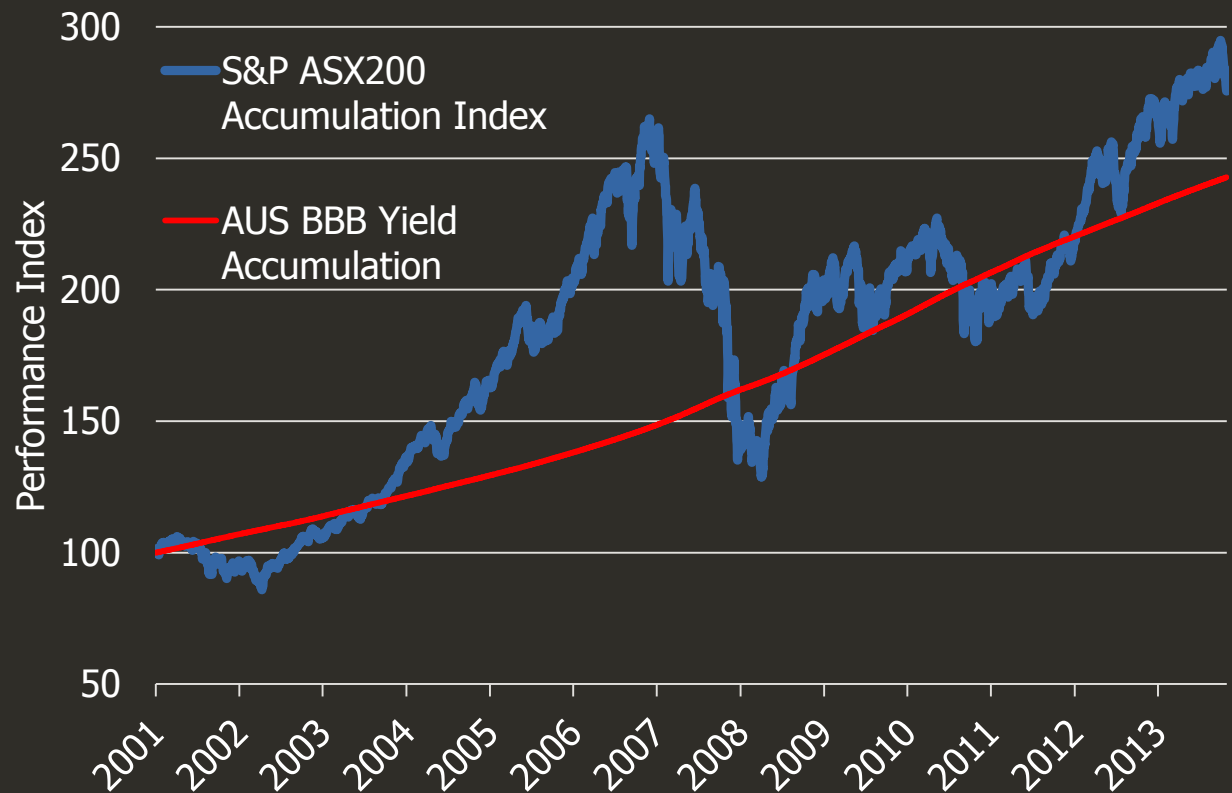
FIIG originated bond

Total cashflows	
Total cash invested	-\$1,190,704
Total cash returned	\$1,485,498
Net increase in cash	\$294,793

Bottom line

Best strategy is equities and bonds in combination, depending upon your age and the environment

Corporate Bonds perform better in 55% of 5 year periods over the past 15 years
BBB Accumulation vs ASX Accumulation, 2001-2015



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