

An Individual Corporate Bonds Story

1 August 2017

Graeme Bottrill

My Disclaimer:

The same as the AIA disclaimer.

I am an amateur.

Don't take notice of anything I say!

My Bonds Story

1. Introduction:

Why did I become interested in bonds?

What types of bonds?

What affects bond prices?

2. My experiences – What have I done?

3. What have I learnt?

1. Why did I become interested in bonds ?

Why Bonds:

Or, the question I asked myself –

Why not Property? Cash ? Equities ?

Cash –

Current returns are almost negative after inflation.

Property –

We have enough allocation to property.

Equities –

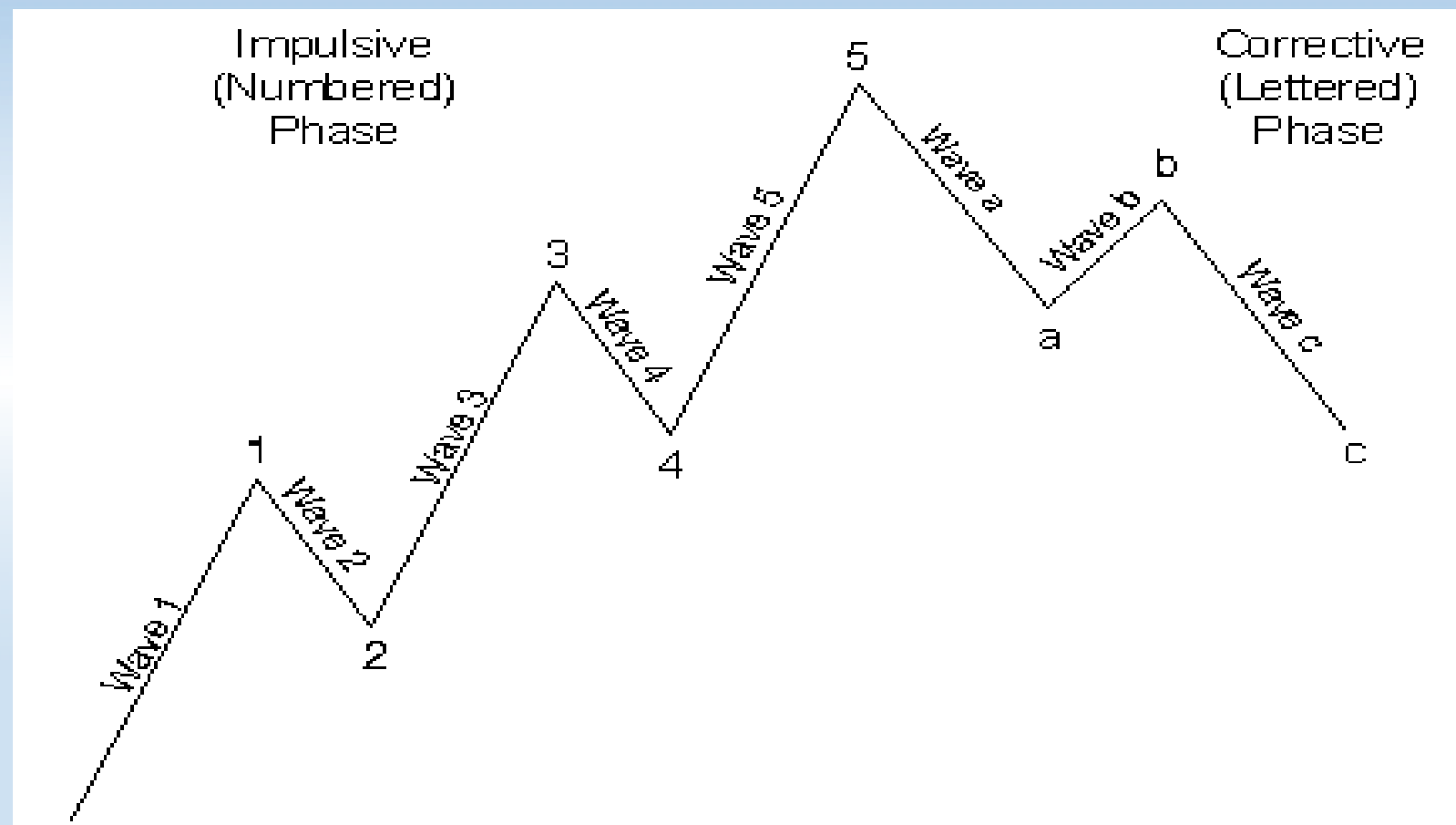
For the last few years, I have perceived a high risk.
(I don't have 40 years to recover a serious loss!)

Equities – What risk?

The risk that I perceived was a potential downturn -

- Elliott Wave theory
- Gann theory
- Benjamin Graham

Elliott Wave





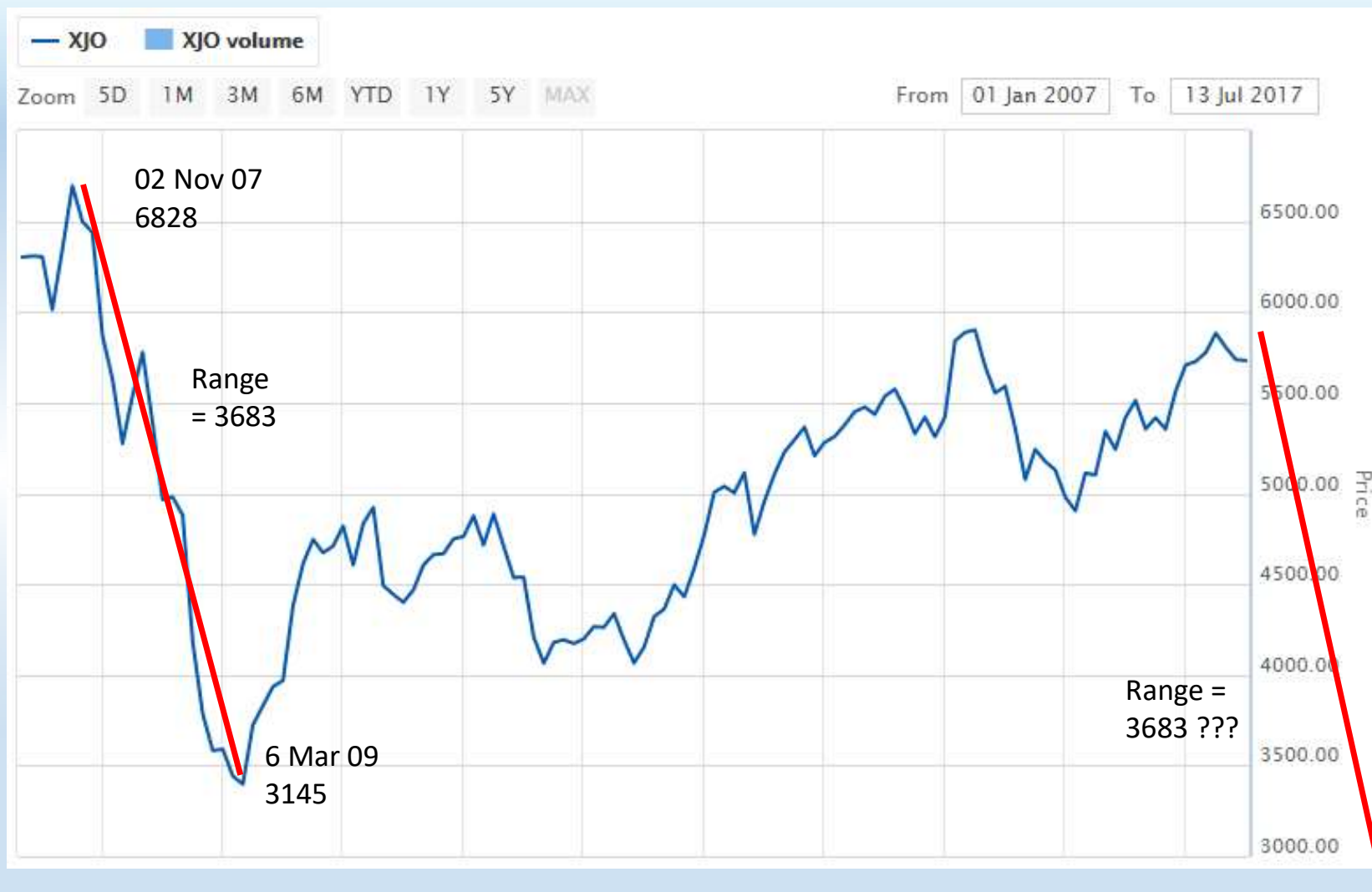
William Gann

Gann's methods are based on a natural order for everything. Gann would often use Biblical passages as a basis for his trading.

Passages often quoted by Gann from Ecclesiastes

Ecc1 1:9-10 “What has been, will be again; what has been done will be done again.”

Ecc1 3:15 “Whatever is has already been, and what will be has been before.”

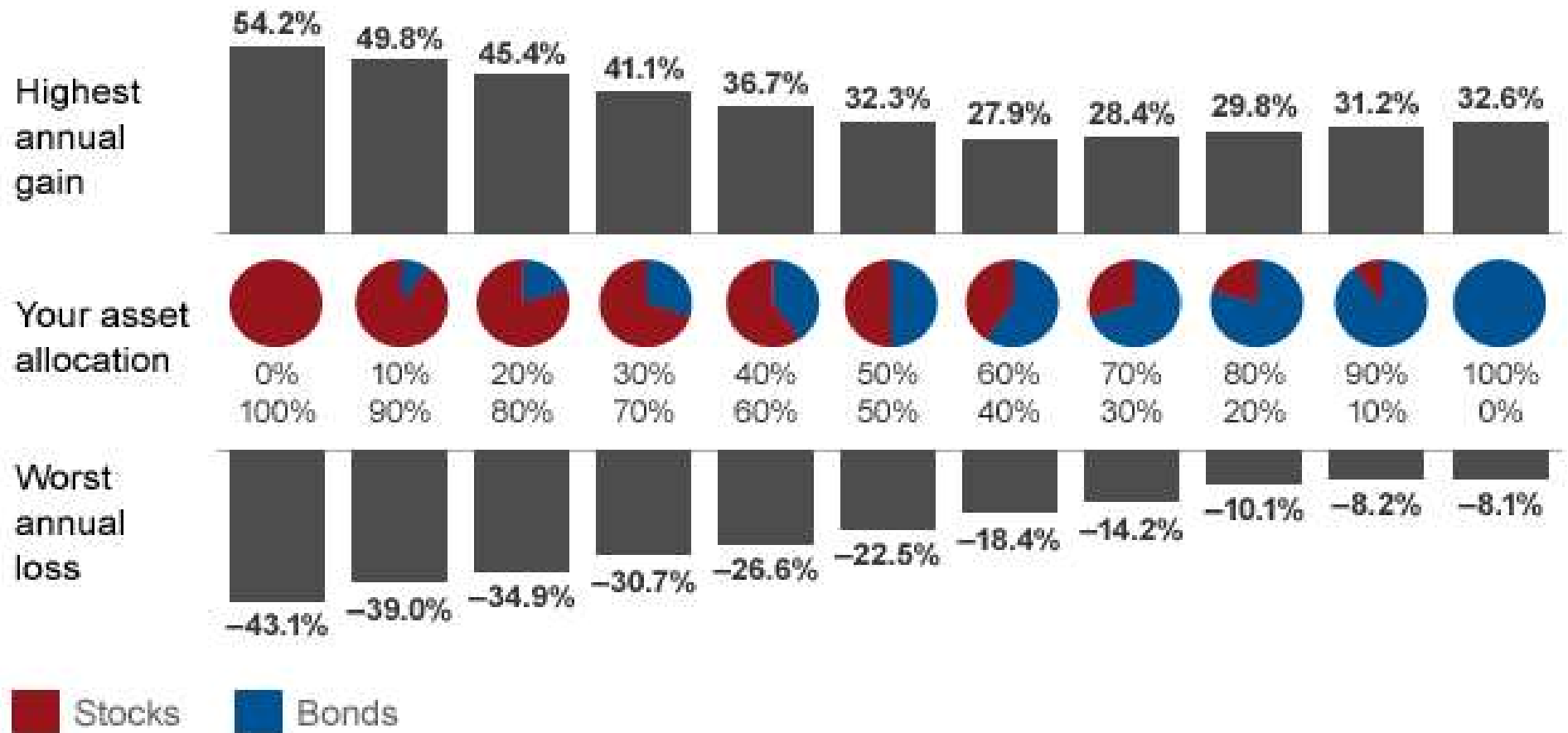


Benjamin Graham

*“We recommended that the investor divide his holdings between high-grade bonds and leading common stocks; that the proportion held in bonds be **never less than 25% or more than 75%**, with the converse being necessarily true for the common stock component,.....”*

(The Intelligent Investor (1973) Chapter 1 – Investment v’s Speculation)

Adding bonds tends to lower both risk and potential return



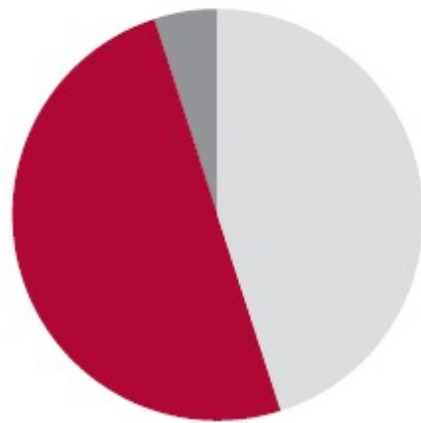
Hypothetical model portfolios

Conservative portfolio



■ 20% Equities
■ 70% Bonds
■ 10% Cash

Moderate portfolio



■ 50% Equities
■ 45% Bonds
■ 5% Cash

Adventurous portfolio



■ 80% Equities
■ 20% Bonds
■ 0% Cash

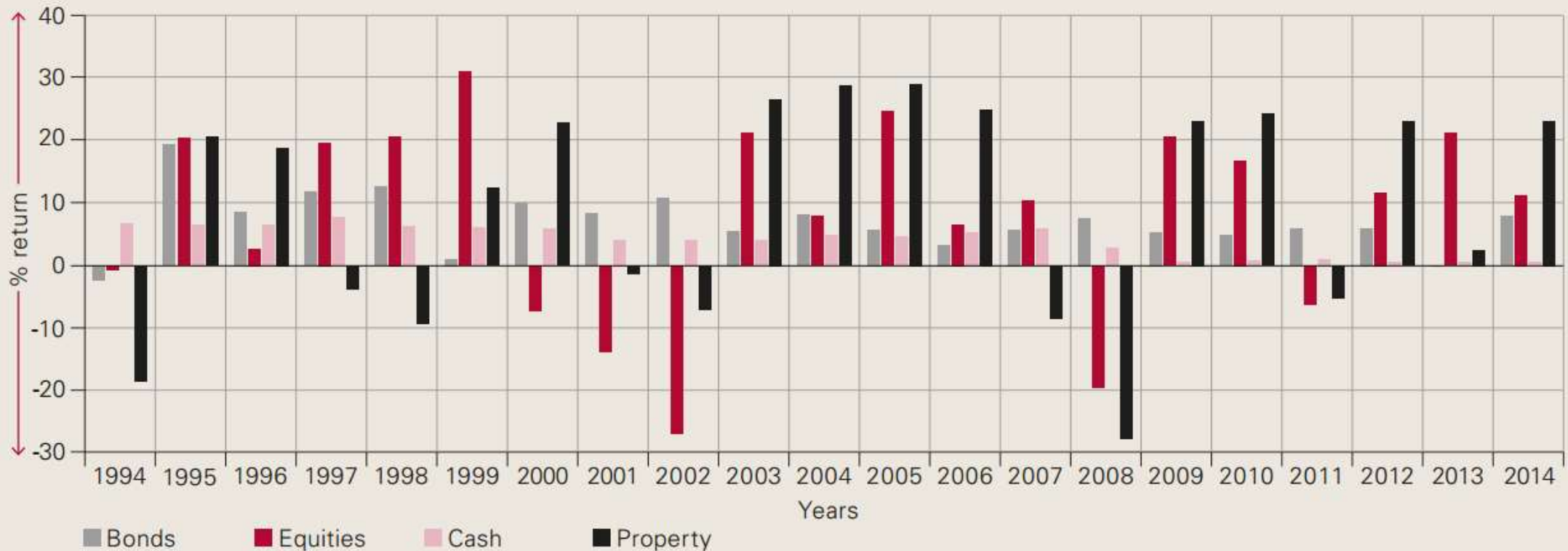
These examples are hypothetical portfolios, and are provided for illustration purposes only. They are not a replacement for financial advice.

The **conservative** portfolio has a low proportion of equities, and may suit those with low risk tolerance and/or a short time to invest.

The **moderate** portfolio has a lower percentage of equities compared to bonds, and may suit investors with medium risk tolerance and/or a medium investment time frame.

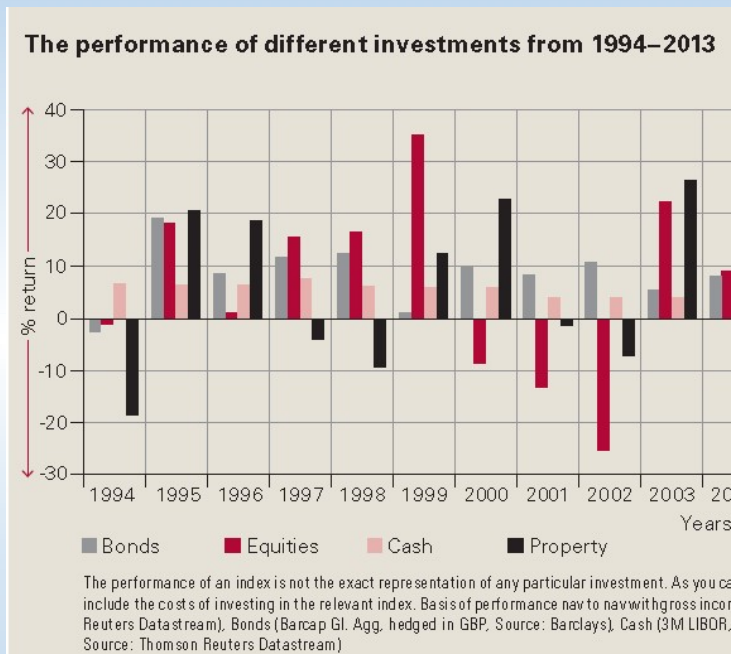
The **adventurous** portfolio, with a high proportion of equity-based investments, may suit investors with high risk tolerance, and/or those with a long investment time frame.

The performance of different investments from 1994–2014



The performance of an index is not the exact representation of any particular investment. As you cannot invest directly into an index, the performance shown in this table does not include the costs of investing in the relevant index. Basis of performance nav to nav with gross income reinvested. Indices used: Equities (MSCI AC WORLD in GBP, Source: Thomson Reuters Datastream), Bonds (Barcap GI. Agg, hedged in GBP, Source: Barclays), Cash (3M LIBOR, in GBP, Source: Bloomberg), Property (FTSE NAREIT Developed Index, in GBP, Source: Thomson Reuters Datastream)

Performance of Various Asset Classes



- Bonds have the highest return in 4 of 21 years.
- Equities won 5 of 21 years.
- Bonds return is greater than equities in 7 of 21 years.
- Property wins in 11 of 21 years.
- Cash won one year, back in 1994.

2. Types of Bonds

- Fixed Rate
- Floating rate
- Inflation linked
- Annuity (Indexed Annuity Bonds)
- And, some variants on the above (amortising, etc.)

3. Bond Prices

There are formulae for calculating bond prices
(not today!)

- Coupon Rate
- Rating (if rated)
- Yield
- Time to maturity
- Potential calls
- Next instalment (and frequency)

4a. My Experiences

So what did I do? I started slowly!

How have I performed?

Some examples of the return from various bonds -

Issuer Type Maturity Rating	Purchased	\$	Coupon Interest		Total Return	%	Days Held	Annualised Holding Period Return %
SCT Logistics	24/06/15	50,000.00						
Fixed Rate Bond			Dec15					
24JUN2021								
7.65%								
Private rail transport operator								
	Sold							
Sold @ 103.6 in 4.5 months	06/11/15	51,823.56						
Good offer for the fixed.								
(I kept the floating)	Profit / Loss	1,823.56		0.00	1,823.56	3.65	135	9.86

Issuer Type Maturity Rating	Purchased	\$	Coupon	Interest	Total Return	%	Days Held	Annualised Holding Period Return %
G8 Education	02/08/13	50,000.00						
Fixed Rate Bond			Feb14	1,912.50				
AUG 2019			Aug14	1,912.50				
			Feb15	1,912.50				
7.65%			Aug15	1,912.50				
Early Learning Centres								
	Sold							
	13/01/16	52,723.33						
Sold to fund new issue	Profit / Loss	2,723.33		7,650.00	10,373.33	20.75	894	8.47

Issuer Type Maturity Rating	Purchased	\$	Coupon Interest	Total Return	%	Days Held	Annualised Holding Period Return %
FMG Resources	15/01/15	59,963.25					
Fixed Coupon Bond (\$US)			Nov15	2,870.58			
NOV2019							
8.25%							
\$50,000 US							
\$50,000 US							
	Sold						
	09/03/16	65,634.48					
This one was struggling							
Got out nicely, to fund CML	Profit / Loss	5,671.23		2,870.58	8,541.81	14.25	419
							12.41

Issuer	Type			Coupon		Total		Days	Annualised
Maturity	Rating	Purchased		\$ Interest		Return	%	Held	Holding
									Period
									Return %
LaTrobe Financial		12/06/15	51,590.95						
Floating Rate Note RMBS Class E				Jul15	443.42				
JAN2047				Aug15	340.68				
BB				Sep15	374.98				
1mBBSW+6.25%				Oct15	318.74				
				Nov15	352.04				
Property finance, res. Mortgages				Dec15	363.84				
				Jan16	330.12				
				Feb16	352.82				
				Mar16	365.15				
				Apr16	320.02				
				May16	342.33				
		Sold		Jun16	366.16				
		15/06/16	49,771.12						
Seemed like it would never perform									
		Profit / Loss	-1,819.83		4,270.30	2,450.47	4.75	369	4.70

Issuer Type Maturity Rating	Purchased	\$	Coupon Interest	Total Return	%	Days Held	Annualised Holding Period Return %
Newcrest Finance	12/02/15	75,267.83					
Fixed Coupon Bond (\$US)			May15	2,135.08			
NOV2019			Nov15	2,423.72			
BBB-			May16	2,361.34			
5.75%							
\$60,000 US	Sold						
Gold Miner	04/07/16	73,560.54					
Probably a mistake taking \$US							
	Profit / Loss	-1,707.29		6,920.14	5,212.85	6.93	508
							4.98

Issuer Type Maturity Rating	Purchased	\$	Coupon Interest		Total Return	%	Days Held	Annualised Holding Period Return %
CML Group	23/03/16	50,000.00						
Fixed Rate Note			Apr16	284.00				
MAR 2022			May16	333.50				
Senior secured			Jun16	333.50				
8.0%			Jul16	333.50				
Factoring & employment/payroll			Aug16	333.50				
			Sep16	333.50				
Callable MAY18 @ \$104			Oct16	333.50				
MAY19@ \$103; MAY20@ \$102			Nov16	333.50				
	Sold							
Fully valued	22/11/16	51,641.70						
	Profit / Loss	1,641.70		2,618.50	4,260.20	8.52	244	12.75

Issuer Type Maturity Rating	Purchased	\$	Coupon Interest	Total Return	%	Days Held	Annualised Holding Period Return %
Eric Insurance Limited	30/07/16	50,000.00					
Fixed Rate Note			Feb17	2,527.50			
AUG 2026							
Subordinated Tier 2							
10.0%							
Callable 4 AUG 2021 @ \$104							
	Sold						
Small company, keep short!	23/02/17	52,162.43					
	Profit / Loss	2,162.43		2,527.50	4,689.93	9.38	208
							16.46

Issuer Type Maturity Rating	Purchased	\$	Coupon Interest		Total Return	%	Days Held	Annualised Holding Period Return %
Newcastle Coal Infrastructure	10/03/15	166,635.25						
Fixed Coupon Bond (\$US)			Apr15	8,215.63				
Callable 31 MAR2027			Sep15	8,892.54				
25 Aug 2031			Mar16	8,155.83				
12.5%			Sep16	8,129.66				
\$100,000 US			Apr17	8,199.65				
Coal terminal			Sep17					
	Sold							
	14/07/17	157,033.11						
	Profit / Loss	-9,062.14		41,593.31	31,991.17	19.20	857	8.18

Current Holdings

- How some current holdings are performing

Issuer Type Maturity Rating	Purchased	\$	Coupon	Interest	Total Return	%	Days Held	Annualised Holding Period Return %
Cash Converters	19/09/13	50,000.00						
Fixed Rate Bond			Mar14	1,987.50				
19 SEP 2018			Sep14	1,987.50				
Not rated			Mar15	1,987.50				
7.95%			Sep15	1,987.50				
			Mar16	1,987.50				
			Sep16	1,987.50				
			Mar17	1,987.50				
			Sep17					
Current Valuation	30/06/17	51,413.00						
Current Yield 7.88								
	Profit / Loss	1,413.00		13,912.50	15,325.50	30.65	1,380	8.11

Issuer	Type							Annualised
Maturity								Holding
Rating	Purchased	\$		Coupon Interest	Total Return	%	Days	Period
							Held	Return %
MPC Funding	18/06/14	49,419.50						
Index Annuity Bond	20/11/14	51,717.50						
31 DEC 2033		101,137.00						
AA		-363.53	Sep14	506.70				
7.5%		-733.04	Dec14	1,015.64				
Melbourne Convention Centre		-739.07	Mar15	1,012.90				
		-745.15	Jun15	1,010.10				
		-751.28	Sep15	1,015.48				
		-757.45	Dec15	1,017.53				
		-763.68	Mar16	1,017.87				
		-769.96	Jun16	1,011.59				
		-776.30	Sep16	1,008.54				
		-782.68	Dec16	1,015.31				
		-789.12	Mar17	1,018.73				
		-795.61	Jun17	1,020.45				
Cost less capital return		92,370.14						
							155	
Current Valuation	30/06/17	91,823.00					953	
Current Yield 7.54								
Profit / Loss		-547.14		11,670.84	11,123.71	12.34	1108	4.07

Issuer Type Maturity Rating	Purchased	\$	Coupon Interest		Total Return	%	Days Held	Annualised Holding Period Return %
McPhersons Ltd	31/03/15	50,000.00						
Fixed Coupon Bond			Sep15	1,775.00				
31 MAR2021			Mar16	1,775.00				
7.1%			Sep16	1,065.00				
sold \$20k 10/04/16	10/04/16	-20,100.00	Mar17	1,065.00				
Redemption			Sep17					
		29,900.00						
							376	
Current Valuation	30/06/17	31,850.00					446	
	Profit / Loss	1,950.00		5,680.00	7,630.00	19.52	822	8.67

Issuer Type Maturity Rating	Purchased	\$	Coupon Interest		Total Return	%	Days Held	Annualised Holding Period Return %
SCT Logistics	24/06/15	50,000.00						
Floating Rate Note			Sep15	826.33				
Callable JUN 2017 @ \$103			Dec15	821.28				
Callable JUN 2018 @ \$101.5			Mar16	843.93				
24 JUN2019			Jun16	843.75				
3mBBSW+4.40%			Sep16	824.11				
(2.03%)			Dec16	782.22				
Private rail transport operator			Mar17	731.00				
			Jun17	797.71				
			Sep17					
Current Valuation	30/06/17	50,945.00						
Current Yield	6.50							
	Profit / Loss	945.00		6,470.33	7,415.33	14.83	737	7.34

Issuer Type Maturity Rating			Coupon Interest		Total Return	%	Days Held	Annualised Holding Period Return %
WA Stockwell	29/06/15	180,000.00						
Fixed Rate Bond			Sep15	3,488.40				
29 JUN 2021 \$130k sold	06/11/15	-132,517.85	Dec15	969.00				
7.75%			Mar16	969.00				
Qld property			Jun16	969.00				
			Sep16	969.00				
			Dec16	969.00				
			Mar17	969.00				
Amortisation		-7,142.85	Jun17	969.00				
		<hr/>						
		40,339.30					130	
Current Valuation	30/06/17	43,507.00					602	
Current Yield	7.45	<hr/>						
	Profit / Loss	3,167.70		10,271.40	13,439.10	18.92	732	9.44

Yield Calculation

\$180,000		
		\$71,016 average
\$47,482		
	130 Days	602 Days
		Total 732 Days
		$(180,000 \times 130 \text{ Days} + \$47,482 \times 602 \text{ Days}) / 732 \text{ Days} = \$71,016$

Issuer Type Maturity Rating	Purchased	\$	Coupon Interest		Total Return	%	Days Held	Annualised Holding Period Return %
Integrated Packaging Group	24/09/15	100,000.00						
Fixed Rate Bond			Mar16	3,650.00				
SEP2019			Sep16	3,650.00				
Not rated			Mar17	3,650.00				
7.3%			Sep17					
Industrial and agricultural packaging								
Callable SEP2016 @ \$102 or SEP2018 @ \$101								
Current Valuation	30/06/17	103,645.00						
Current Yield 7.10								
Profit / Loss		3,645.00		10,950.00	14,595.00	14.60	645	8.26

Issuer Type Maturity Rating	Purchased	\$	Coupon Interest		Total Return	%	Days Held	Annualised Holding Period Return %
Axsess Today	01/10/15	50,000.00						
Floating Rate Bond			Jan16	1,117.70				
9 OCT 2021	23/09/16	50,927.67	Apr16	1,098.85				
Not rated - But BBB??			Jul16	1,092.41				
3mBBSW+6.5%		100,927.67	Oct16	2,110.45				
Private commercial retail finance			Jan17	2,054.36				
			Apr17	2,064.33				
			Jul17	2,063.08				
Callable OCT2017 @ \$103 or OCT2020 @ \$101.50			Oct17					
							358	
Current Valuation	30/06/17	104,015.00					280	
Current Yield 8.58								
	Profit / Loss	3,087.33		11,601.18	14,688.51	20.30	638	11.61

Issuer Type Maturity Rating	Purchased	\$	Coupon Interest		Total Return	%	Days Held	Annualised Holding Period Return %
Sunland Capital	25/11/15	50,000.00						
Fixed Rate Note			May16	1,887.50				
25 NOV 2020			Nov16	1,887.50				
			May17	1,887.50				
7.55%			Nov17					
Property development								
Current Valuation	30/06/17	51,869.00						
Current Yield	7.23							
	Profit / Loss	1,869.00		5,662.50	7,531.50	15.06	583	9.43

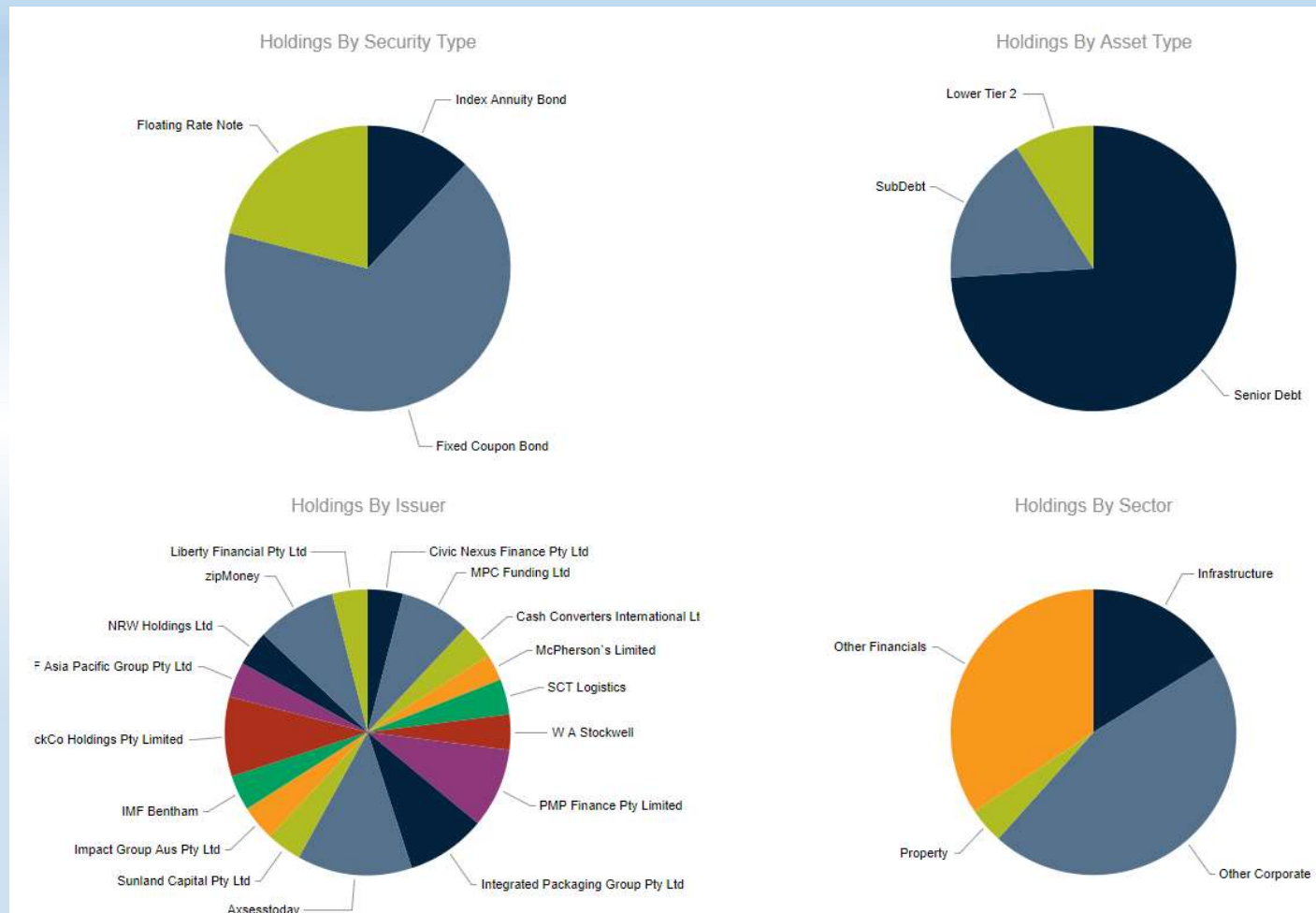
Issuer Type Maturity Rating	Purchased	\$	Coupon Interest		Total Return	%	Days Held	Annualised Holding Period Return %
Impact Group	12/02/16	50,000.00						
Fixed Rate Note		-1,111.11	May16	1,126.37				
JAN2021		-1,111.11	Aug16	1,038.89				
Senior secured		-1,111.11	Nov16	1,015.28				
8.5%		-1,111.11	Feb17	991.66				
Principal amortising approx. 2%		-1,111.11	May17	968.06				
Qld Home builder			Aug17					
Callable JAN2019 @ \$103		44,444.45						
or JAN2020 @ \$101.50								
Current Valuation	30/06/17	45,703.00						
Current Yield	9.30							
Profit / Loss		1,258.55		5,140.26	6,398.81	13.55	504	9.81

Issuer Type Maturity Rating	Purchased	\$	Coupon Interest		Total Return	%	Days Held	Annualised Holding Period Return %
StockCo	10/10/16	50,000.00	Nov16	364.50				
Fixed Rate Note			Dec16	364.50				
6 OCT 2022	13/03/17	50,106.00	Jan17	364.50				
Subordinated			Feb17	364.50				
8.75%			Mar17	364.50				
Livestock funding / finance			Apr17	729.00				
Callable Oct 2019 at \$103,		100,106.00	May17	729.00				
Oct 2020 at \$101.50,			Jun17	729.00				
or Oct 2021 at par.			Jul17	729.00				
			Aug17				154	
Current Valuation	30/06/17	105,254.00					109	
Current Yield 8.32								
	Profit / Loss	5,148.00		4,738.50	9,886.50	13.97	263	19.39

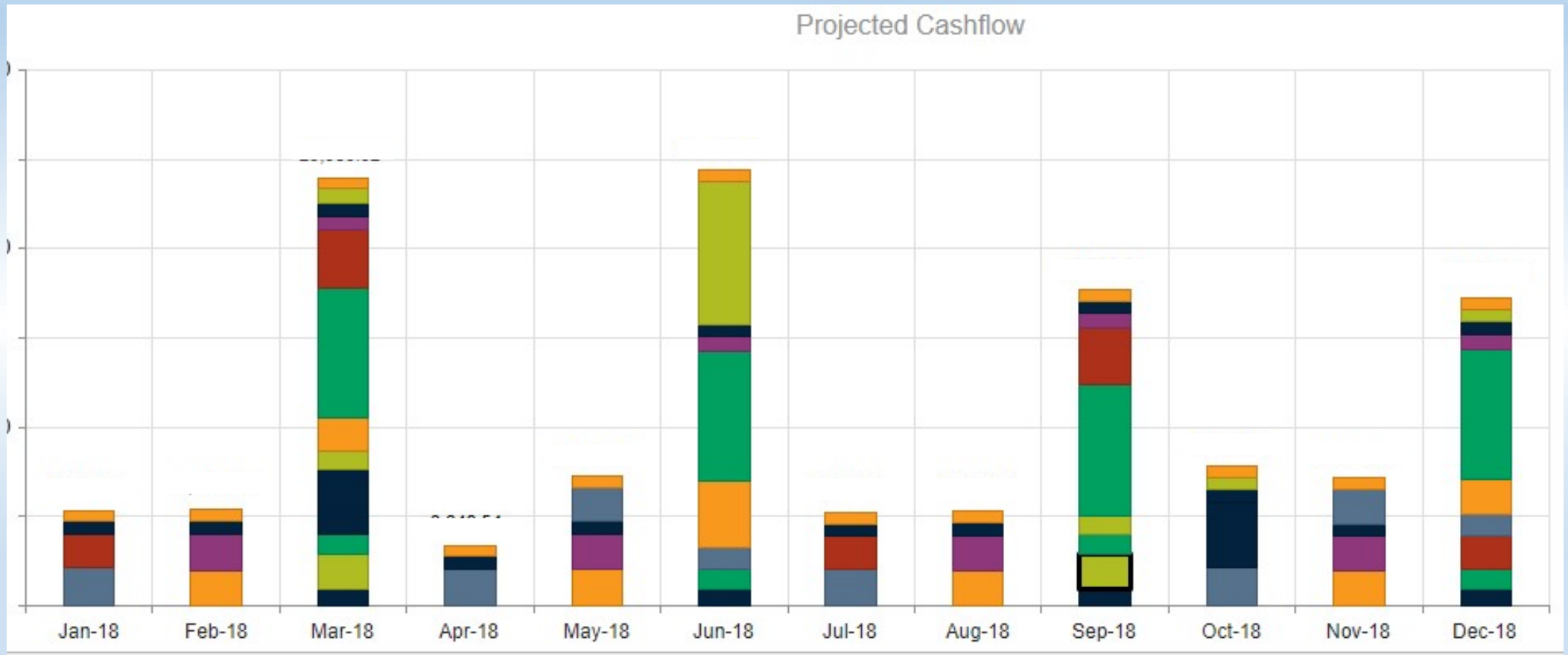
Issuer Type Maturity Rating	Purchased	\$	Coupon Interest		Total Return	%	Days Held	Annualised Holding Period Return %
CF Asia Pacific Group	28/11/16	50,000.00						
Fixed Rate Note		-1,050.00	Feb17	1,043.75				
30 NOV 2020		-1,050.00	May17	1,021.83				
Senior secured			Aug17					
8.35%			Nov17					
Amortising \$21 per \$1,000 per quarter								
		47,900.00						
Current Valuation	30/06/17	49,192.00						
Current Yield	7.75							
	Profit / Loss	1,292.00		2,065.58	3,357.58	6.86	214	11.70

Issuer	Type			Coupon		Total		Days	Annualised
Maturity	Rating	Purchased	\$	Interest		Return	%	Held	Holding Period
NRW Holdings Ltd		15/12/16	100,000.00						Return %
Fixed Rate Note			-5,417.00	Mar17	1,875.00				
DEC2020			-5,520.00	Jun17	1,772.00				
Senior secured fully amortising									
7.5%									
Amortising ~\$5,500 per quarter									
Civil & mining contractor									
Callable at each interest payment date									
from December 2018 at 102% and									
from December 2019 at 101%			89,063.00						
Current Valuation	30/06/17		90,023.00						
Current Yield	7.75								
		Profit/Loss	960.00		3,647.00	4,607.00	4.87	197	9.03

My current portfolio (\$AUS)



Cashflow



4a. My Experiences

How have I performed?

ASX 200 Performance -

30-Jun-14	5525		
30-Jun-15	5459	-1.19	%
30-Jun-16	5233	-4.13	%
30-Jun-17	5728	9.45	%
	3 years	3.67	%

4b. My Experiences

What have I learnt?

- I thought I was just buying a coupon
- Watch the call dates
- Be aware of market interest rates
- Don't have favourites

Which Bonds do I buy?

- I like new issues
- I look for companies with stable cash-flow
- In current times I am concentrating on short-dated high yield bonds.

For how long should I hold a bond?

There are only three options!

Option 1 – Hold to Maturity

Hold to maturity and receive the coupon interest along the way, and the face value returned at maturity.

- Risk of interest rate movements
- Risk of the company fortunes changing

For how long should I hold a bond?

Option 2 – Sell prior to Maturity

Hold for a period and receive the coupon interest along the way. Sell when '*appropriate*' at a capital gain (or loss!)

- Risk of selling too soon (price rises after selling)
- Risk of not being able to achieve the same yield elsewhere.

For how long should I hold a bond?

Option 3 – The Issuer calls the Bond prior to Maturity

- The issuer company often has the right to call, ie. pay back the bond (at an agreed value).
- The potential call dates and payments are known.

Considerations

- Is it a new issue (at par), or an existing bond (at a premium or a discount)?
- What type (fixed, floating, inflation linked, etc.)?
- What is the yield?
- How long to maturity?
- What is the likely interest rate movement in this time and how might this bond be affected?
- What do I think about the company?

Considerations (cont'd)

- Is the bond rated?
- Are there call date(s) ?
- How will the market value the bond?
- What risk am I taking?
- Am I being adequately rewarded?
- Read the research
- Understand the business

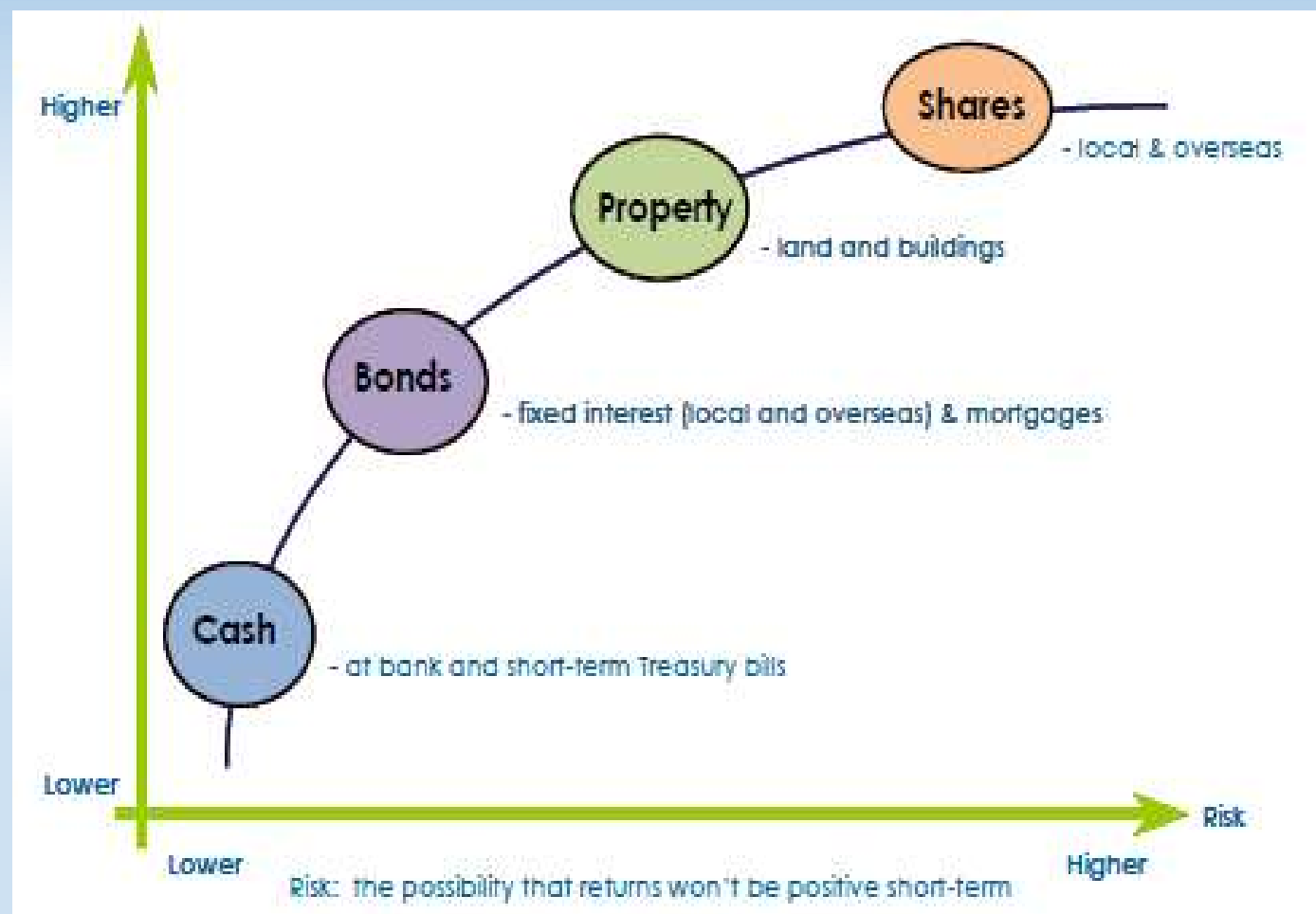
My Plan

- My bond portfolio average yield, currently 7.29% (coupon)
Plus capital gain, say 0 - 10%
- Total portfolio return for 2017 fin year = 10%
- Annualised holding period returns between 3.6% and 27%. Typically in the 6-10% range
- That is all I need to live on and cover inflation, and hold for better times.

My Plan

- I monitor performance – every bond every month
- Active management
- Have a watch-list of bonds to be sold at opportunity
- I turn over the lower rated bonds more frequently than investment grade bonds. Their fortunes may change!

Risk v's Reward



Benjamin Graham –

Chapter 4 – General Portfolio Policy: The Defensive Investor

“It has been an old and sound principle that those who cannot afford to take risks should be content with a relatively low return on their funds.

From this there has developed the general notion that the rate of return which the investor should aim for is more or less proportionate to the degree of risk he is ready to run.”

Benjamin Graham –

“Our view is different. The rate of return sought should be dependent, rather, on the amount of intelligent effort the investor is willing and able to bring to bear on his task.

The minimum return goes to our passive investor, who wants both safety and freedom from concern.

The maximum return would be realized by the alert and enterprising investor who exercises maximum intelligence and skill.”

Warren Buffet says –

“To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insights, or inside information.

What’s needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework.”

I would add – The ‘*sound intellectual framework*’ is built on knowledge and education.



Broker's Recommendations(Was slide 50)

I Often receive suggestions and I review every one.
there are '*recommendations*' that I do not entertain.
The broker makes a margin every time we buy or sell.

However, the broker knows that we need to make a profit to keep playing the game.