

What is a Corporate bond, simple?

In principle, a corporate bond is a loan to the company issuing the bond. In return for the loan, the issuer pays interest to the lender (holder of the bond = investor).

For which investors are corporate bonds relevant?

Generally, corporate bonds have a lower rating/credit worthiness than government and mortgage bonds, but as an investor you have the opportunity of obtaining a higher return on these bonds. Corporate bonds may be a good supplement to an equity portfolio, as generally corporate bonds deliver more stable returns than equities.

A corporate bond differs from a share by being a loan to the company while a share is an ownership interest in the company. Corporate bonds are generally safer than equities because bond investors are paid first if the company goes into bankruptcy. But the expected return will be lower for corporate bonds than for equities.

Credit risk and ratings

There are various categories within corporate bonds. They are Investment Grade (also known as High Grade) and High Yield. Investment grade bonds are the safest bonds offering the lowest yields. There is a higher risk involved in high yield bonds, but in return they offer higher yields. The category of the individual bond is determined by its rating. The rating is an assessment of the credit worthiness and expresses the probability that a company can and will pay the money owed to the investor. Ratings are issued by rating agencies like Moody's, S&P and Fitch.

Security

A corporate bond may be secured, which means that a specific asset has been put up as security for the debt. Generally in the event of a default, holders of secured bonds will therefore get their money back before holders of unsecured bonds. It is also important in a default situation whether the debt is ranked as senior or junior debt. Senior lenders will get their money before junior lenders.

Pros and cons

Corporate bonds	
<p>Pros</p> <ul style="list-style-type: none"> • By assuming an extra risk, investor gets a return opportunity that is above that of conventional government and mortgage bonds. • Investor receives regular interest payments. • Good supplement to an equity portfolio 	<p>Cons</p> <ul style="list-style-type: none"> • Corporate bonds involve greater risks than investment in government and mortgage bonds.

What happens in practice?

To buy bonds you must have available in your account the full purchase amount. After the purchase, you will regularly receive interest on the bond. The price of the bond is determined by supply and demand and by investors' expectations of the issuing company.

Return

The total return depends on both the price and the yield on your bonds. If you purchased a bond with a fixed coupon rate, you can expect fixed interest income. The price may vary over time and may influence your total return if you sell the bond before maturity.

About risk

The price may change if there is a change in the creditworthiness of the issuer of your bond, which for most bonds is expressed through a rating. Typically, a low rating means a higher risk of default. Ratings are issued by credit rating agencies (e.g. Moody's, S&P and Fitch) and they apply different scales ranging from the best to the poorest rating. You should therefore consider the rating of the bond. Typically, there is a correlation between the credit rating of the issuer, the risk and the expected return. The lower the credit rating, the higher the risk and the higher the potential reward.

Prices on your bonds fluctuate in step with changes in the interest rate level. This is especially true for fixed rate bonds as the price on these bonds will rise when interest rates fall and the price will fall when interest rates rise. The longer the maturity of your bonds, the more sensitive the price will be to changes in the interest rate level.

Generally, corporate bonds involve a significant liquidity risk, which is aggravated by market unrest. Relative to investment grade corporate

bonds, high yield corporate bonds will be more volatile, and therefore investors may experience significant fluctuations.

If you invest in a bond denominated in another currency (for instance, euro) than your base currency (for instance, the Danish krone), you assume an exchange rate risk.

When using benchmarks (e.g. interest rate benchmarks) in corporate bonds, you must be aware of the risk that these benchmarks are or can be subject to national, international or other initiatives, which may mean that the composition of the benchmark is changed or that the benchmark completely disappears.

Further information is available at:
trustednovusbank.gi/general-terms/fallback-plans

According to the risk classification, corporate bonds traded in a regulated market (stock exchange such as OMX or another authorised market place) will be categorised as amber, while the rest will be red.

Read more about the risk classification of investment products at:

trustednovusbank.gi/investmentinformation

We recommend that you seek advice from professional advisers about any accounting and tax consequences before you buy corporate bonds.

Tax

We do not give advice on tax issues in connection with specific transactions. If you wish to learn about the specific importance of the tax rules for you, we recommend that you consult your accountant.

What you should know before trading

We recommend that your investment profile is reviewed before you engage in transactions. Your relationship manager can help you with that. We also recommend that you contact your relationship manager if you have any questions in relation to anything described in this fact sheet, or if, generally, you would like to have some points clarified.