GOLF, AND HOW IT RELATES TO *Bonds*

LET'S GO *golfing*

Here is a great tip for learning about Bonds.

Using Golf as an Example, It is Easy to Understand and Relate to Bonds.

"Think of your bonds like playing golf. Sometimes you make pars, birdies and bogeys. Bonds are much the same way, if you buy a bond at initial issue, it is like making a par. If you buy bonds at a premium, it is like making a bogey, you paid higher than par. If you buy bonds at a discount, it is like making a birdie, you bought the bond at less than par."

This simple explanation really works so that everyone can easily understand bonds.

PAR: Price equal to the face amount of a security; 100%.
PAR

DISCOUNT A bond sold at less than par.
BIRDIE

PREMIUM: The amount by which the price of a security exceeds its principal amount.
BOGEY

HERE ARE SOME TERMS ABOUT BONDS WORTH LEARNING AND BEING FAMILIAR WITH.

CALLABLE: Subject to payment of the principal amount (and accrued interest) prior to the stated maturity date, with or without payment of a call premium. Bonds can be callable under a number of different circumstances, including at the option of the issuer, or on a mandatory or extraordinary basis.

CALL DATE: The date at which some bonds are redeemable by the issuer prior to the maturity date.

CALL PROTECTION: Bonds that are not callable for a certain number of years before their call date.

CALL RISK: The risk is that declining interest rates may accelerate the redemption of a callable security, causing an investor's principal to be returned sooner than expected. As a consequence, investors may have to reinvest their principal at a lower rate of interest.

MARKETABILITY: A measure of the ease with which a security can be sold in the primary and secondary market without an undue price concession.

MARKET PRICE OR MARKET VALUE: For securities traded through an exchange, the last reported price at which a security was sold; for securities traded "over-the-counter," the current price of the security in the market.

MATURITY DATE: The date when the principal amount of a security becomes due and payable, if not subject to prior call or redemption.

RISK: A measure of the degree of uncertainty and/or of financial loss inherent in an investment or decision. There are many different risks, including:

- **Call Risk**—As stated earlier, there is risk that declining interest rates may accelerate the redemption of a callable security, causing an investor's principal to be returned sooner than expected. Therefore, investors may have to reinvest their principal at a lower rate of interest.
- **Credit Risk**—The risk that the obligor on the bonds will be unable to make debt service payments due to a weakening of their credit.
- **Event Risk**—The risk that an issuer's ability to make debt service payments will change because of unanticipated changes, such as a corporate restructuring, a regulatory change or an accident, in their environment.
- **Market Risk**—Potential price fluctuations in a bond due to changes in the general level of interest rates.
- **Underwriting Risk**—The risk of pricing and underwriting securities and then ultimately not being able to sell them to the investor.

YIELD TO CALL: A yield on a security calculated by assuming that interest payments will be paid until the call date, when the security will be redeemed at the call price.

YIELD TO MATURITY: A yield on a security calculated by assuming that interest payments will be made until the final maturity date, at which point the principal will be repaid by the issuer. Yield to maturity is essentially the discount rate at which the present value of future payments (investment income and return of principal) equals the price of the security.

ZERO-COUPON BOND: A bond for which no periodic interest payments are made. The investor receives one payment at maturity equal to the principal invested plus interest earned compounded semi-annually at the original interest rate to maturity.

INVESTMENT GRADE: Bonds considered suitable for preservation of invested capital; ordinarily, those rated Baa3 or better by Moody's Investors Service, or BBB- or better by Standard & Poor's Corporation (see "ratings").

HIGH-YIELD BOND: Bonds issued by lower-rated corporations, sovereign countries and other entities rated Ba or BB or below and offering a higher yield than more creditworthy securities; sometimes known as junk bonds.

DEBENTURE: Unsecured debt obligation, issued against the general credit of a corporation, rather than against a specific asset.

HERE ARE SOME COMMON BOND TERMS:

- **BOND**: A bond is a debt instrument issued by a borrower, typically a government or corporation, to raise capital. When you buy a bond, you are essentially lending money to the issuer in exchange for periodic interest payments and the return of the principal amount at maturity.
- **COUPON RATE**: The coupon rate, also known as the nominal or stated rate, is the fixed annual interest rate that the bond issuer agrees to pay to bondholders. It is usually expressed as a percentage of the bond's face value.
- **FACE VALUE**: The face value, also called the par value or principal, is the predetermined amount of money that the bond issuer promises to repay to bondholders at maturity. It is typically $1,000 for corporate bonds and government bonds.
- **MATURITY DATE**: The maturity date is the date on which the bond reaches its full term, and the issuer must repay the face value to bondholders. Bonds can have short-term (less than one year), medium-term (one to ten years), or long-term (over ten years) maturities.
- **YIELD**: Yield represents the return an investor can expect to receive from a bond, considering both the coupon payments and the price paid for the bond. It is usually expressed as a percentage and can be calculated in different ways, such as current yield, yield to maturity (YTM), or yield to call (YTC).
- **CREDIT RATING**: Credit rating agencies assess the creditworthiness of bond issuers and assign ratings to their bonds. Common rating agencies include Standard & Poor's (S&P), Moody's, and Fitch. Higher-rated bonds are considered less risky and generally offer lower yields, while lower-rated bonds carry higher risks but potentially higher yields.
- **CALLABLE BONDS**: Callable bonds give the issuer the right to redeem the bonds before their maturity date, usually at a premium. This feature allows the issuer to refinance the debt if interest rates decline, potentially leaving bondholders with reinvestment risk.
- **PUTTABLE BONDS**: Puttable bonds provide bondholders with the option to sell the bonds back to the issuer before maturity at a predetermined price. This feature gives bondholders some flexibility and protection in case of unfavorable market conditions.

These are just a few fundamental bond terms. Bonds can have additional features, such as convertible bonds, zero-coupon bonds, and floating-rate bonds, each with their own unique characteristics. It's important to understand the specific terms and features of a bond before investing and consult with a financial advisor or do thorough research to make informed investment decisions.

THE "Back Door Escape Hatch" TIP

This tip really works when you are dealing with bonds. Many bonds issued in today's market have a callable feature to them. This means that if the bond issuer can offer the same bonds at a lower interest rate than they are currently paying, they will "call" the bonds and reissue.

The risk to the bond buyer is two-fold:

1. The bond owner will receive the funds from their bond being called and be forced to look at lower interest options because interest rates are lower.
2. If the bond is not called, then that would mean that interest rates in general are higher. The bond owner is then "**stuck**" with the bond they own and it is paying less than the prevailing general interest rates.

"It appears that you bought a bond with a back door escape hatch. This means the bond company can change the rules if it is in their best interest."

A Very Good site to visit is:
Callable (or Redeemable) Bond Types, Examples, Pros & Cons (investopedia.com)

