
BUYING INTO BONDS

With lots of world-wide volatility in the markets, bonds are generally more of a reduced risk investment alternative.

A bond pays an investor interest over a period of time as well as the full investment at a predetermined maturity date.

WHAT ARE BONDS?

A bond is simply a long-term loan. Most people have at some stage applied for a loan at a bank and had to pay interest on the amount of the loan. The bond market operates in exactly the same way.

A bond is a financial instrument that promises that the borrower (a company or a government) will pay the holder (investor) interest over a period of time and repay the full amount of the loan on a predetermined maturity date.

Just as people need money, so too do companies and governments. If a company, a government or a financial institution wants to borrow money, one of the ways it can do so is by issuing a bond. The borrower agrees to pay interest on a regular basis and to repay the full amount of the loan at a predetermined date.

It is common that when capital is borrowed, the borrower will want to pay the lowest possible interest. Similarly, the investor will want to receive the highest possible interest. The investor is concerned about getting their money back and on time. It is for this reason that issuers of bonds are credit rated and classified according to their ability to repay the debt.

Bonds are less risky than shares as they are more stable – but they pay less. Another difference is that when an investor buys shares it constitutes ownership in the company with voting rights. The investor makes money when the company makes money. But if an equity company is liquidated, an investor stands last to claim against the company, as he is treated as a shareholder. However, when investors invest in bonds, this constitutes a claim on a specified stream of income.

This means the issuer borrows cash and promises to pay it back with the reward of interest. Should the issuer become liquidated for whatever reason, bondholders, as creditors of the issuer, are given first preference and are paid first.

HOW ARE BONDS STRUCTURED?

Investors in bonds lend a specified amount of money to the borrower for a specified period of time.

The investor will receive fixed payments of interest regularly as long as the bond exists. The interest payment date is determined beforehand as well as the interest receivable.

The investor receives the full principal amount at maturity as well as the interest payment.

Examples

- **Fixed-rate:** Most traditional bonds pay a fixed rate at regular intervals.
- **Floating-rate:** These bonds have variable interest rates that are reset or adjusted periodically according to the benchmark they are linked to, such as the Johannesburg Interbank Agreed Rate (Jibar) or the consumer price index (CPI).
- **Zero-coupon:** These bonds pay no periodic interest. Instead they are sold at a substantial discount to the fair value and redeemed for the full face value on maturity.

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Anyone can invest in bonds on Yield-X, including institutions and individuals. The minimum amount to invest ... is one thousand rand, with no maximum restriction

WHY INVEST IN BONDS?

- Dependable income: Bonds provide investors with a regular and steady income in the form of interest while preserving their initial investment amount (principal).
- Portfolio risk diversification: Bonds can help investors to spread assets across different asset classes of the financial market, thereby minimising the risk of concentration in any one asset class.
- Security: Bondholders usually have priority over stockholders when a company is liquidated and are more likely to receive payment.
- Safety: Bonds are usually evaluated and rated based on credit history and ability to pay interest and repay obligations on time. The higher the rating the safer the investment and the less likely the bond issuer will default (AAA a better rating than B or C).

HOW DO I BUY A BOND?

Investors can buy and sell bonds through a broker, just like shares. If you are not already a client of a broker, you will be assisted by your broker to set up an account and transact with a minimum delay.

Your broker will be able to offer you advice and trade on your behalf.

WHO CAN INVEST IN BONDS?

Anyone can invest in bonds on Yield-X, including institutions and individuals. The minimum amount to invest in bonds through Yield-X is one thousand rand, with no maximum restriction.

Investors can invest in government and corporate bonds, for example R153, R157, Eskom, Telkom or SA Breweries.

CAN I MAKE MONEY TRADING IN BONDS?

Yes, depending on the movement in the price (yield). Investors can buy or sell bonds at regular intervals to take advantage of interest rate movements.

For additional information please contact the JSE Yield-X Division at yieldx@jse.co.za or JSE Limited on 011 520 7000.

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