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#### Questions & Answers – Corporate Bonds

Q Why should I be considering corporate bonds rather than shares at the moment?

A Corporate bonds carry less risk than ordinary shares held in the same underlying companies, because the company is obliged to pay the coupon every year at the stated level whereas it is not obliged to pay any particular dividend on its shares. With expectation of falling profits as the economy slips further into recessions, dividends are likely to fall. But the coupon payments on bonds will be maintained at their fixed level, unless the company is unable to meet its obligations, and defaults on its payment.

As with government gilts, investors will normally gain access to corporate bonds through investment funds that specialise in these securities of which there is a wide range to choose from. This also means that the investment is spread over a wide range of bonds, reducing the risk even further. Corporate bonds funds are big news at the moment because the current yields look very attractive compared to government bonds, and the fact that they are generally more secure than shares. The high yields currently available will look even more attractive as deposit interest rates are falling. Just as government bonds performed exceptionally well in 2008, corporate bonds are expected to perform well in 2009, and as the demand for the high yield increases, the price of bonds starts to rise.

Since the annual coupon payment of a bond is fixed for the life of the bond, as the Market price rises so the running yield falls. For example, if the market price of a bond rises 50%, the future income yield as a percentage for any new investors buying in at the higher price is reduced accordingly.

Funds that invest in the highest grade corporate bonds, and therefore carry least risk, currently quote yields in the range of around 7% to 8%. There is also the opportunity of capital appreciation as well, as the high yield attracts investors and pushes market prices higher.

Knowing which fund to invest in is critical. Funds that offer the highest yields specialise in sub-investment grade bonds, where there is a greater risk of defaults. A lot depends on the experience and research capabilities of the fund manager.

Our view is that, for most clients, those funds that are able to span the yield range, generally known as strategic bond funds, are likely to offer the best pound-for-pound performance on a risk-adjusted basis. Much depends on the client's personal risk profile, and wealthier clients are better placed to shoot for the highest yields, which can be well above 10% per annum.

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