TRANSCRIPT

Finding value in corporate bonds

Presenters: Richard Carter and Steven Shaw

[00:00:00.15] JONATHAN LAMOTHE: Hello, everyone, and welcome to our Finding Value in Corporate Bonds with Fidelity and Bondsavvy webinar today. My name is Jonathan Lamothe, and I want to thank you for taking time out of your busy days to spend it with us learning about the opportunities that corporate bonds may bring to your portfolio.

[00:00:15.12] Today, I am joined by Richard Carter, Vice President of Fixed Income Products and Services, and Steve Shaw, founder and CEO of Bondsavvy. Richard and Steve are going to take some time over the next hour or so to dive into the corporate bond market to uncover how 2023 is different from 2022, as well as things to consider before buying a bond and how to manage the sale of bonds. But for now, I'm going to turn it over to Richard Carter and Steve Shaw. Guys, take it away.

[00:00:40.65] RICHARD CARTER: Thank you, Jonathan. Appreciate that. And thank you everyone for joining us today. My name is Richard Carter, and I'm very honored today to introduce our guest, Stephen Shaw actually back to our fixed income webinar series. Steve is founder and President of Bondsavvy-- a research service that specializes in helping individual retail investors invest in individual corporate bonds. Steve's a 25 year veteran of the financial markets. He's worked in corporate mergers and acquisitions, as well as he's spent some time heading up the bond trading venue, Tradeweb Direct. Steve founded Bondsavvy in 2017.

[00:01:19.87] So Steve, it's great to have you back. Thank you for rejoining us again this year, and we'd love to hear your insights into the corporate bond market. But before we do, perhaps I could ask you to just tell our audience a little bit about yourself and what inspired you to launch Bondsavvy.

[00:01:38.14] STEVE SHAW: Sure, absolutely. And first, Richard, thank you so much for inviting me back again. I believe this is our sixth year doing this. So thank you to you and Fidelity. So when I'm not trying to keep my blood pressure low raising two teenagers, I've developed, what I believe, is a differentiated expertise in analyzing individual corporate bonds from the perspective of individual investors.

[00:02:02.90] And if I go back a number of years, I was sitting at my desk and I had a colleague that was sitting to my right and I was on fidelity.com, and I saw that there was this Apple bond that was priced at about 85. And I asked her, I said, what do you think about this investment? And she's like, you should probably do it. And so I made the investment, and one of the things that I saw right away was that it was very efficient to invest in corporate bonds. You could do it just like a stock. The execution happened in a matter of seconds.

[00:02:33.04] But then I also saw the benefits of investing in individual corporate bonds. I saw that this bond was priced at a good price from an excellent issuer. So there was an opportunity for capital appreciation, there's an opportunity for income. And so I started to think, well, these are investments that make a lot of sense but very few people take advantage of them. When I speak to friends and family, most people are in bond funds or they're in stocks, and I found a bond side because I wanted to change that. I wanted to make bond investing easier, I wanted to make it more profitable, and felt that investors needed some tools that narrowed down the universe a little bit better than is currently out there today. So that's why I started the company.

[00:03:16.66] RICHARD CARTER: Awesome. Well, it sounds like we're aligned in that philosophy, Steve. So again, welcome back. Let's jump in. 2022, for many bond investors, was a bit of a tough year. The Federal Reserve raised rates at the most aggressive pace in many decades. But as a result, we have got now some pretty decent higher yields for people too as they look at the bond universe with, generally speaking, some decent credit conditions.

[00:03:43.91] So before we dive in to how you find value, what are some of the basics? Perhaps, some of our newer listeners and viewers might like to know about corporates and corporate bonds do.

[00:03:56.72] STEVE SHAW: Absolutely. And probably the best way to start, Richard, is to give an example of a corporate bond because I believe that many investors, especially those who might be new to the corporate bonds, might get a little intimidated and that's why they might stick with stocks or some other investments. But the example that we have here on slide 4 is a bond that's issued by Lennar. So Lennar is a large homebuilder based in Florida. And what we show on this slide is we show what are the fixed components of a corporate bond, as well as the variable components because these two different parts interact with each other.

[00:04:35.81] And the first part about this corporate bond is you see Lennar 5.875%, and then there's this date, 11/15/24-- all that means is that the bond pays an interest of 5.875%-- I'll explain what that means in terms of dollars in a moment-- and then, you're due the face value of the bond, which is $1,000 on November 14 of 2024. You'll see this number here, this nine digit code, it's called the CUSIP. Since many companies will issue more than one bond, you need to have an identifier that's more detailed than a stock ticker. So Ford will just have its one ticker symbol for its stock. But Ford has as many different bonds, and so that's why there's this nine digit code to identify the bond. And when you go and execute a trade, that's what you actually type in.

[00:05:25.74] When we look at the left side of this page, we look at what are the terms that are never going to change? So what's never going to change is the coupon for the bond. So since the face value of the bond is $1,000 and it pays 5.875%, if you multiply those two numbers together, that's the annual interest that you receive. So $58.75, it gets split in two semiannual payments. In this case, it's always one payment on the maturity date, which is on the day and month of the maturity, November 15. And then another date six months from that, which is May 15.

[00:06:00.39] So coupon payment, payment dates, face value, maturity date-- those won't change. So it doesn't matter what you pay for the bond, those are always going to be the same. Now, if we go over to the right, these things do change. Now, you'll remember that this bond was issued back in May of 2018. And since then, there have been lots of things that have happened. So obviously, you had COVID happen in 2020, then you had huge spike in interest rates during 2022. So lots of different things happened.

[00:06:32.59] And when you look at these two different dates that we show here-- so we show October 2nd of 2020, so that was obviously after markets had recovered after the onset of COVID, and then April 11, 2023-- you'll see that the ask price of this bond changed. So it was 113.4. And just so folks know what that means-- bonds are coded differently than stocks. So bonds are quoted as a percentage of their face value. When you see a bond quoted here at 113.4, that's 113.4% of the face value of the bond. Since the face value of the bond is $1,000, the value of this bond would be $1,134. So just so folks are aware of how that works.

[00:07:13.48] And as you might expect, this bond fell in price. So it fell from 113 down to close to par on April 11th because Treasury yields and interest rates went up so much. The silver lining of that is that if you go back to October 2020, this bond had yielded to maturity of 2%, and now, it's north of 5% for a really strong issuer.

[00:07:36.69] The last couple of points here-- the bond rating, so that's obviously from the Moody's and S&P of the world. This bond was rated high yield-- so what's called double B's, or BA.1, double b plus-- but then it was actually upgraded after COVID. And so you've now got a case where you've got a higher credit quality bond and it's paying more. So if you compare investing now versus investing a few years ago, it's a more compelling time. Obviously, there are risks, which we'll talk about in a moment. We'll talk about credit spread in a couple of slides, but just keep those numbers in mind. You see the 1.79% and the 1.24%-- we'll refer back to those and how those relate to where market credit spreads have been historically.

[00:08:19.79] RICHARD CARTER: That's very interesting, Steve. So I mean, again, just to recap, you've got those fixed elements on the left, there. And I think when you come to the right, though, and look at the shifting nature of yield-- and as you say the credit rating, actually in this case was upgraded, it does get a little bit overwhelming for people sometimes just to sort of say, well, when when's the right time? I thought I was buying this thing for forever until it matures. How do you look at this oscillation that you've just illustrated a bit and use that as part of your value identification process.

[00:08:52.85] STEVE SHAW: Sure. And one of the biggest benefits that investors in individual bonds have, Richard, is that bonds are priced relative to par value. And you can immediately start to assess where you are on that par value scale, and you can compare where the bond is priced, what it's yielding, and you can look at financial metrics, you can look at growth and all different sorts of things.

[00:09:16.14] What we showed here on slide 6 is an example of another bond. So this is target 390s of November 15 of 2047. Now, you'll remember par is 100. So the par value of the bond is 100% of the par or face value, those terms are used interchangeably. So you see that this bond will be priced at $1,000. And the annual coupon for this bond, remember, it was 3.9% coupon. So it's going to pay $39. Again, it doesn't matter whether you bought the bond at 80 or whether you bought the bond at 120, it's always going to pay you $39 a year.

[00:09:55.68] Now, why this chart is so important is, you look at where this bond is priced today. So you look on the left side of par. So anything below par is deemed to be a discount to par value, anything above par is deemed to be a premium. So a couple of weeks ago, this bond was priced at 87.7. So an investor can right away think, OK, Target, obviously a good company. Investor can do some analysis and figure out, OK, what do its financials look like? But then the investor can also get an idea of where is it trading with regard to where it can possibly trade?

[00:10:28.65] Because if you buy a corporate bond, you've got a different set of goalposts than you have with stocks. You can buy a stock at $5 and it could go up to $250. Bonds don't do that because, remember, we've got the fixed component of a bond. So we have fixed maturity date, fixed coupon-- those things will effectively tether where a value of a bond can go. And so in this case, if you look at the left, the bond went all the way down to 75 on October 21 of 2022 because that was really the peak of Treasury yields. But then it went all the way up to 137.74 as markets recovered from COVID. So those are the goalposts. And so it's important to keep in mind that, let's say we bought this bond at around 90, and then it has some price appreciation, it gets up to 115, 120. That's when we start to think about, OK, should we start to sell the bond? And those are concepts that we'll talk about a little bit later on.

[00:11:29.25] The last point I wanted to mention on this slide, Richard, is you look at the bottom row of data, shows the yield to maturity. And what that yields the maturity factors in is, not only the income that you're receiving, but also, the opportunity for capital appreciation from the price that you buy the bond at-- so a maturity price or the face value. So in this case, let's say I bought the bond at 80, the yield to maturity was around 5.4%. So that factors in not only the $39 a year that I get in income, but also the 20 points of capital appreciation between now and maturity.

[00:12:07.41] It works on the other way-- if you buy a bond at a premium-- because there, let's say you bought the bond at 120, then you're going to lose 20 points of capital between the purchase and the face value. What we like to do is, we like to buy bonds down here on the discount, on the left side, and then ideally sell them at a premium on the right side. Doesn't always happen that way, but that's the objective.

[00:12:35.10] Now, one of the things that I talked about a couple of slides ago was credit spreads. And all a credit spread is-- it's the difference between what the Treasury is yielding and what the corporate bond is yielding. So if we compare a 20 year Treasury to a 20 year corporate bond, it's the difference between those two yields because it's deemed that a corporation is going to have a higher risk of default than the US government, and you have to be compensated for that extra risk. So what we show, here, on the left is the blue line is the constant 20 year maturity for US Treasuries, and the green is that the Moody's investment grade, B/ AA 20 year yield.

[00:13:19.91] And so the difference is, as I mentioned before, is the credit spread. So if you look at the chart on the right, that's how the credit spread has changed over time. And as you might expect, there were two periods where those credit spreads really exploded. You've got in 2008, so you've got the great financial crisis, where it went all the way up to 5%. You then had the onset of COVID in 2020, where were they spiked again. And then 2015, you had oil prices fall from about $100 down to $30. And so thinking of turmoil on the economy, different things such as such as that.

[00:13:54.24] But if you look at this chart over the entire period generally it's between 1 and 1/2 to 2 and 1/2 for kind of a BBB credit. That can obviously change over time, but just keep that in mind as we talk about credit spreads a little bit further in this presentation.

[00:14:14.08] RICHARD CARTER: Great job there, Steve. On the right again, the spread chart, you mentioned the spikes and the great financial crisis of '08, '09 and then the 2020 COVID spike-- I guess we haven't quite reached that point, but where do you assess the economy currently? We have the increase in rates that are pretty dramatic we saw last year, we're still undergoing. And we had recently the banking turmoil-- how does that play into this, kind of, more macro picture when it comes to looking at this chart?

[00:14:47.10] STEVE SHAW: Sure. Well, the interesting thing is that this chart, it gives the impression of the quality of the economy in terms of where we're headed. So when you had those shocks, that's when credit spreads were the widest. Now, you look at it, it's sort of in a middle range. But when we look at the economy, we focus on the bond issuers. So we have we've got 56 bond recommendations across close to 50 issuers in 16 industries. So we get we get the full gamut of how companies are doing. And yes, there are companies, especially in retail, that have struggled. But generally speaking, the issuing companies of the bonds we recommended have been doing pretty well.

[00:15:30.56] But the important thing to keep in mind is that from an investors standpoint, that's just a point in time. So those companies might look great today, but one of the reasons why it's so important to monitor your bond investments over time is because that can change. Now, oftentimes it won't change overnight, but it can change gradually. That's one of the things that we look very closely at.

[00:15:53.70] So many people will ask, well, when you think about bonds and all the turmoil that happened over the last couple of weeks, what did that mean to bonds? Because nobody was thinking that these large reasonably sized banks would all of a sudden just disappear overnight. And what we show on slide 9 is, we show what's been happening with US Treasury yields and what's been happening with the Fed funds rate, and how that impacted corporate bonds.

[00:16:23.73] And so you'll see in the black in the chart, that's the effect of Fed funds rate. So as everybody knows, that's obviously been going up, up, up. And the Treasury yields have been following suit. So in the blue, that's the two-year US Treasury yield, to the yellow is the 10-year Treasury yield. And people thought these things are just going to keep going up for a really long time. And what happened was you hit March 8th, and that's when the two year peaked at a little bit north of 5%.

[00:16:53.70] And then you had Silicon Valley Bank go out of business. And what happened was, there was this change in belief that OK, well, maybe the Fed will be less hawkish and rates aren't going to go up as high. So you had Treasury yields fall significantly. And if you go back about a month or so ago, people would ask, well, why would I ever buy a three-year corporate bond if I could buy a three year CD? And these are the things that can happen in that, you had short-term yields fall off a cliff, bond prices go up, and you're able to achieve some nice capital appreciation, there, that people didn't necessarily think were in the cards.

[00:17:33.42] And I'd say the most important thing from this slide is just to understand, when you invest in corporate bonds you want to have a variety. So we don't believe it just makes sense to have long-dated investment grade or short-dated investment grade, it makes sense to have a variety with investment grade, high yield, different maturities, so that you can be well positioned to take advantage of things that may not necessarily be expected.

[00:17:57.16] When we then boil it down to specific bonds, because we can look at a chart and we can look at aggregate yields and all that kind of stuff, but it doesn't help inform how we then make investment decisions at an individual bond level. And what we show, here, is we show three different corporate bonds, and we show how the yields of these corporate bonds have changed. And we start at March 8th and we end it March 20th just so we can see how things changed so significantly.

[00:18:32.28] So three examples-- we've got two Apple bonds. Obviously, Apple-- nearly $400 billion of revenue. One of the most successful companies in the world. We've got one bond that's due in 2046, one bond that's due in 2025, and then we have a bond issued by a company called Vital Energy, which is a $1.8 billion oil and gas company primarily in the Permian Basin. And what we show, here, is we showed the building blocks of a corporate bond's yield to maturity.

[00:19:01.17] And to give an example, we're going to look at the Vital Energy bond on March 8. So on March 8, that bond-- so you see these two bars here-- that bond had a yield to maturity of 10.11%. And if we go up a little bit, you'll see the price was right around par, 100.02. This yield to maturity had two components to it. So it had the credit spread, and then it had what's called the benchmark US Treasury yield. So there's a US Treasury that matures right around when this Vital Energy bond matures, right around November. I'm sorry, January of 2028. And the yield to maturity of that bond was 4.34% on March 8. You'll see there's a pretty big difference between the Vital Energy yield to maturity and that. Difference in orange is called the credit spread because you're being compensated for the extra risk you're taking.

[00:19:56.34] And if you think about it, it makes up the lion's share of the yield to maturity. You compare that to the other extreme, this very short-dated Apple bond. So this Apple bond, 2 and 1/2 due in 2025. On March 8, that bond had a yield to maturity of 5.22%, but its credit spread was so tiny-- it was 0.17%. So owning that Apple bond at that point in time was very similar to owning the US Treasury because the driver of that bond wasn't the financial performance of Apple, but it was what happens with the US Treasury market. And it's just important for folks to understand that.

[00:20:40.00] So when you look at this Apple bond-- yes, the yield to maturity did go from 5.22 down to 4.20, but since it's a short-dated bond, there wasn't that big of a change in the price. It went from 95 to close to 97. That actually first rotated bond that is a decent amount, it's 2%. But if you compare it to the longer-dated Apple bond, in this case, the yield to maturity just fell from 4.87 to 4.63, but because it's a long-dated bond, it had a greater impact on the price of that bond. So the reason why this page is important is that it gives you an idea of what really causes bond prices to move. These investment grade bonds, like Apple, they're heavily impacted by what happens in the US Treasury market, to a lesser extent what happens with the performance at the company. But high yield issuers, especially such as Vital Energy, they're heavily impacted by the performance of the company. In this case with Vital Energy, the price of oil and overall economic conditions.

[00:21:40.36] RICHARD CARTER: Yeah. Thanks, Steve. I mean, great slide. I think you've helped us, you say, the distinction between the benchmark rates of the Treasury and then the spreads on top of that. It does make me think a little bit about industry sector. You mentioned earlier about investing in homebuilders and I think a retailer, et cetera. I think you said at some point 16 different industries and things. How do you look at that in this context? Are there certain sectors that have larger spreads than others, would you say?

[00:22:09.90] STEVE SHAW: Sure. So it's interesting because when you look at an industry such as oil and gas, and where the spreads really have the biggest impact is on high-yield bonds because those are the spreads that can get really juicy. When you compare different bonds that are, say, investment grade, you usually often won't see that big of a difference between, say, an ExxonMobil and an Apple. They'll oftentimes have spreads that are very similar. But when you look at different industries, that's where you can start to see some big differences.

[00:22:43.65] And one of the things that's really interesting is to see how different bonds of different industries and different maturities have been performing. And what we show here, Richard, on slide 11 is four different bonds. On the upper row, we show to high-yield bonds and the bottom row we show two investment grade bonds. Now, on the left side, we show two oil and gas bonds. So we show Vital Energy, which as I mentioned before, midsize oil and gas company-- $1.8 billion of revenue. And then we show ExxonMobil, the industry behemoth, with over $400 billion of revenue.

[00:23:22.23] And we look at what's happened to both of these bonds from the middle part of 2021, and you'll see that both bonds fell. They were both at peaks in 2021, before there was turmoil in the market in 2022. But you'll see, here, that this Vital Energy bond paid a coupon of north of 10% compared to ExxonMobil of 2.44%. And the minute we think, well, ExxonMobil bond, it was in oil and gas, so it must have done great as oil prices skyrocketed over the last year or so. But because this ExxonMobil bond was so influenced by Treasuries, you'll see that the bond fell 22 points from peak to trough. The Vital Energy bond also fell, but it fell 16 points. But the fact that you had a 10% coupon, it actually generated a positive return for that bond.

[00:24:17.88] Now, many folks would be interested in thinking, well, what happened with investment grade bonds? And what if I went to the highest credit quality bond that was out there? And so there are only two companies that are rated AAA-- Johnson and Johnson and Microsoft. And so Johnson and Johnson bought them right here. You'll see that this bond got hammered. It was at 122.5 August 4th of 2021, and then boom-- it had this long slide down to 77 on October 24 of 2022. So down 45 points.

[00:24:53.19] And what's really interesting is that if you compare the price charts of ExxonMobil, of J&J, and then the bond up in the upper right of Ford-- which is what's called a fallen angel because it used to be investment grade-- these charts, they're almost carbon copies of one another in that they started high and then they fell, and then they recovered a little bit. So one of the things that's important with a slide like this is that we do believe it's important to invest across a variety of bonds, and we say a variety-- we don't think you need a portfolio of hundreds of bonds, but we do believe it's important to own bonds that are issued by companies in different industries that have different maturity dates because you don't want to be a one trick pony, and just own longer dated investment grade bonds because you see how similarly these bonds performed over the last nearly two years.

[00:25:49.74] RICHARD CARTER: Absolutely. All right, Steve. Well, listen, I think this is the perfect time, then, to ask you to roll back the curtain and show us a bit more about your investing process, if you would. I mean, you mentioned earlier, there's just so many bonds, right? There's thousands of companies and then each company typically has more than 10, 20, maybe even hundreds of bonds. So how do you start and begin to screen this large universe?

[00:26:14.59] STEVE SHAW: Sure. So we start our work on fidelity.com and going through the bonds-- so the 9,000 corporate bonds that are available. And we download all of those bonds, and we start fairly wide because sometimes we can be surprised, in terms of some of the bonds that are available. But the first thing that we start with is, well, where are we, right? And where are we in terms of the economy? When we look at different industries, are we thinking that we should not be investing in certain industries? For instance, we made a set of recommendations March 26th of 2020-- we were not investing in cruise ships, obviously at that point.

[00:26:59.56] But what we can start to do is we can start to narrow the universe and say, OK, how are we thinking about industries? How are we thinking about investment grade versus high-yield because the bonds that really took it on the chin over the last year, year and a half, especially during 2022, have been investment grade corporate bonds. There are obviously been pockets within high-yield but haven't done well. But because high-yield is less sensitive to changes than Treasury yields, there are high-yield bonds that did reasonably well.

[00:27:31.27] We had never recommended a short-term investment grade bond until June of 2022 because they finally became compelling and you could buy a short-term investment grade bond that was yielding north of 4% where you couldn't in the past. So we want to take all the information that's out there and start to come up with an investment thesis just speaking generally. And then we start narrowing it down. So we'll go through all the bonds that we see.

[00:27:58.45] We'll then start saying, OK, we like these different issuers. When we see a different issuer, we then start to put it on our short list. So let's say that we go from 9,000 bonds down to, say, 20 or 25 and maybe that includes eight to 10 different issuers, then we'll start doing our financial analysis. We'll start looking at basic financial ratios, which we're going to talk about in a moment. We'll get an idea in terms of upcoming maturities, the company's capital allocation. So if it earns $1,000,000,000, is it blowing it on stock buybacks or is it being more disciplined and is it is it investing in its business? Is it is it paying down debt? More bondholder friendly things.

[00:28:41.45] And then we get to a point of, OK, well, every quarter we generally make between four to six new recommendations, and those are at the CUSIP level. So we then need to think, OK, of these 15, 20 different bonds, which are the ones that we feel best about? And then it starts to get into things such as looking at the credit spread, looking at what the bond is yielding. If it's a high-yield bond, where is the bond callable because that can limit the upside of the bond. We'll look at, OK, if we're making a recommendation for a bond, is there other debt in the company's capital structure that if things went south, could it disadvantage us? And we'll also look at how liquid a bond is because when we make a recommendation, our subscribers are going to buy that bond. So we have to make sure that there's active trading activity in that bond.

[00:29:36.10] And one of the first considerations that we think about is, where is there value? And is there a value on different parts of the yield curve? Is there value just in the overall market? And what we show here on slide 14 is, these are historical Treasury yields. And it also compares it to the black line, which is the Fed funds rate. You'll see that the Treasury yields are very volatile. Many people will believe that, well, Treasury yields went up and so it's the only way that yields can go. But you'll see that historically they've been all over the map. And what we like to look at is, let's take today, or let's take April 7, and you see that where bonds were yielding at that point in time.

[00:30:26.60] So historically, other than 3/2011, yields were pretty high. So we would generally feel a little bit more confident, in terms of being more aggressive. There would be there'd be more opportunities at this point in time than there was, say, if you go back to early 2021 where bond yields were so low. So we like to get an idea in terms of, OK, where are we historically? Then also, are there opportunities across the yield curve? Or are yields very similar to-- right now, if you looked at April 7, you'll see the 10-year was 339 and the 30-year was 331. So you weren't necessarily getting significantly greater yield by going out longer on the curve.

[00:31:12.23] So we'll start to think about those things. We'll compare it to where the bond is priced, and then we'll start to think about where we are with regard to our credit analysis. There's one other point here where worth mentioning is that, oftentimes when you look at an investment grade bond, you will have a variety of choices because investment grade issuers generally are bigger, in terms of size than high-yield issuers. And so, there could be 10, 12 bonds you could look at. That being said, in high-yield oftentimes you won't have that big of a choice sometimes high yield issuers may only issue two or three bonds, and you won't have as wide a variety of choices when it comes to different maturities.

[00:31:55.17] RICHARD CARTER: Thanks, Steve. Well, as you say, look at this chart-- it gives us all a smile on our faces, right, after being patient bond investors for many years to see the fundamentals are definitely changed, here, and this shows the historical perception of that. Let's dive into those spread-type of metrics, right? So what is it about the company's fundamentals that will lead you one way or the other? How do you-- again, there just seems to be an overwhelming amount of data for people to cut through-- how do you hone in on the key ones.

[00:32:30.02] STEVE SHAW: So we start with a couple of basic financial analysis metrics that might be new to some. So I'm sure everyone has heard of net income and have heard of a PE ratio, or a price to earnings ratio, and that's how an equity investor can start to assess the value of a stock. And that's essentially what we're doing with bonds when we look at different metrics. We're getting an idea of, OK, how does a company's financials compare to where the bond is priced? So it's a similar type of analysis.

[00:33:05.83] With bonds, however, we look at metrics that are a little bit different. So first, rather than looking at net income, we're looking at a metric called EBITDA. And all that is just earnings before interest, taxes, depreciation, and amortization. It can be a mouthful. So depreciation and amortization, we the reason we look at it before that is because those are non-cash items. So we want to add those back.

[00:33:32.80] And then we want to have an idea, before the company pays its taxes and before it pays interest on its debt, we want to have an idea in terms of the cash flow that's available to service the debt. And one of the first ratios that we look at is what's called interest coverage. So all that is you'll look at the company's EBITDA and you divide it by its interest expense. So if you've got a high interest coverage ratio, that's generally good. It means you have a lower risk of default. But if it's low-- and we'll show what low means on the next slide-- then you can start to get a little concerned.

[00:34:09.01] Leverage ratio is another important issue, another important metric. And all that is just total debt divided by EBITDA. And it just gives you an idea of, OK, all the debts. So if the company has got-- let's say, it has $10 billion of debt and it has $5 billion of EBITDA, that would be a leverage ratio of 2 times, which is a pretty solid leverage ratio. Now what we have, here, on slide 16 is what we call the Corporate Bond "Sweat Meter," and this is the case where-- I wanted to give folks an idea in terms of better or worse type of metrics, and in how we then apply that to our analysis.

[00:34:50.12] So if you think about leverage ratios, generally speaking, anything lower than 3 times is generally safe. As you start to get up to 5 and 6 times, that's when you start to get really nervous. And interest coverage works the opposite way. So if you're above 10 times, even if you're a high single digits, you feel you feel pretty good. But once you start getting less than or equal to 2.5 times, this gentleman had to explain to his wife that he was investing in bonds that had 1 times the interest coverage. And if you think about it, you not only have to pay your interest but then you have to pay your taxes. And today's Tax Day, obviously. So you got to pay your taxes. You have to invest in the business through capital expenditures, there might be other expenses that you incur in terms of acquisitions and all sorts of things. So you want to make sure that you've got cushion there.

[00:35:41.39] The important thing with these metrics is that they're just a point in time. So they might enable you to identify a bond that looks good right now, but one of the things that is really important is to always update your analysis. That's what we do, we update our recommendations every quarter because the company might be investment grade today, it might have 1.5 times leverage ratio today, but things are always changing in the business world. And there's always new competitors, always new consumer preference, all these different things that can change a bond issuer from low risk to high risk. And it can also work the opposite way, one that looked really risky but then had performed really well, and is now a much better credit.

[00:36:26.66] RICHARD CARTER: Well, that was very helpful, Steve. Thank you. I love the idea of the "sweat meter," I think as many investors might have experienced that themselves. Would you say that the bond investing, the higher the leverage ratio you mentioned and the lower the interest coverage ratio, does that tend to lead to a greater volatility in the bond spread?

[00:36:52.20] STEVE SHAW: It does. And what we show here on slide 17 is two examples of two different bonds. And on the left is an investment grade grocery company, a leading grocer, and on the right is a high-yield retailer. And we show here in the blue is the credit spread. And the credit spread when we initially made the recommendation and then as we updated every quarter. And so you'll see, here, for the bond and the left, there's been a difference of about one percentage point. So 2.17 all the way down to 1.18.

[00:37:29.08] So as you alluded to, it's not as volatile as when you compare it to, say, a high-yield retailer. This has been all over the place. If you look at what happened in COVID, it was all the way up to 9.69%. Before COVID, some of the rating agencies did downgrade it, but then as this company continued to report strong earnings, the credit spread fell and it became a really compelling investment opportunity. But one of the reasons you can't wait for the rating agencies to issue their ratings is that they didn't actually issue their upgrade S&P until March of '21. And so, because these credit spreads can be very volatile-- especially in high-yield, you have to stay on top of it and do your own analysis and identify when can be really compelling times to make new investments.

[00:38:25.36] RICHARD CARTER: Interesting, Steve. Thank you. So would you say that it's possible to value potential when yields are high and yet the leverage ratio is low? Does it work that way?

[00:38:39.73] STEVE SHAW: Sure. So if you think about finding value-- and so, let's compare it to stocks. So you've got value investors who might be looking to buy stocks that have a PE of seven, eight, nine times compared to a growth investor that would be less sensitive and might be buying stocks at P/E’s of 30 or 40. What we're doing here is we're comparing a bond's price, but more specifically, a bonds spread. When I say spread to Treasury, that's the same term as credit spread.

[00:39:13.82] And then we're going to compare it to the company's financials. So we're going to compare it to its leverage ratio and interest coverage ratio. And what we show, here-- so these are for bond recommendations, bonds having made on March 8. They were all priced, we show the quarter price, here. They all priced in the mid 80s or thereabouts. But they had some fairly juicy credit spreads. So these were credit spreads in the mid-fours to high fours. And if you think back of the examples that we've seen before, you remember the investment grade grocer was somewhere kind of 1.2% to a little bit north of 2%. But here, you're getting an extra 2+% for risk that actually isn't that much higher. Because you've got a nice, what's called a gross credit leverage ratio, here, of 2.5 times. We show also what's called the net leverage ratio. All that is with net, you subtract the company's cash from its debt. And so you'll see the net is a little bit less. If you have negative net leverage, that means there's actually more cash on the balance sheet then there is debt, which is a great thing.

[00:40:27.23] But these are the things that we're assessing. So we're getting an idea in terms of, OK, what are the financials look like? How does that compare to what we have under our pricing and liquidity analysis? So what does the yield to maturity look like? What does the spread look like? And then we also evaluate what's the liquidity in the bond? So we showed the number of quotes, here. We show the amount outstanding of the bond. So generally, if it's a bond that's $1,000,000,000, it's generally fairly liquid. As you start to get the $250 million, that can be somewhat more constrained and not as liquid.

[00:41:02.24] And then we look at a number of other factors because as I mentioned before, a leverage ratio is a point in time. So we need to know how is this company performing? Is the revenue and EBITDA growing? What is the cash look like versus debt? And then, one of the most important things is what upcoming maturities does the issuer have? Because if you look at this bond at the bottom-- so you'll see bond recommendation four, it had $750 million of debt, $2.7 billion of cash, and the next maturity isn't until 2032. So you can rest fairly easily owning this bond. It's rated BB because it's a smaller company. But these are the opportunities that you can find if you dig a little bit deeper.

[00:41:51.72] RICHARD CARTER: Well, thanks, Steve. That gave some great insight into your screening process and actually delivering specific names for people. As we come to the close, how about we move to another important aspect-- when to sell. As you said, your approach is not just buy and hold to maturity, it is quite an active approach. So do you look at these same fundamentals to sell or do you look at more technical analysis? Where do you start there?

[00:42:19.74] STEVE SHAW: Sure. And our focus is maximizing total return. And as you mentioned, a big part of that is deciding when to sell because we all know that, as we talked about before, bonds have to go back to par value. So there can often be nice opportunities if a bond is appreciated significantly to sell that bond before maturity and lock in your capital appreciation. So here, we're going to show three different examples of bonds we've previously sold. Two successes and one that didn't work out well.

[00:42:54.54] And we're going to start off with the Tiffany bond. This is a bond that we recommended September 5th of 2019. It had a price of $103.01. When we look at the bond's yield to maturity on that date, it was 4.7%. So when we looked at Tiffany's financials, they were really strong. And the fact that it had this juicy credit spread of 2.7%, we thought that there was an opportunity for that credit spread to shrink. And if that credit spreads shrunk, the yield to maturity would shrink and the price of the bond would go up.

[00:43:28.38] Now, one of the benefits of owning individual bonds is that you can sometimes be fortunate of events that happen. And so what happened in this case is that Tiffany was announced to be acquired by LVMH. LVMH had at a higher bond rating. And upon the announcement of that deal, what would happen is LVMH would assume the debt of Tiffany. And so the bond went up significantly. Went up from 103 to 128. And you'll see that on January 23, the yield to maturity had fallen down to 3.2% and the credit spread was down to 0.96.

[00:44:08.19] So if you remember back a number of slides were the Apple credit spread was, the Apple credit spread was right around 0.75. So there wasn't going to be that much of an opportunity for this credit spread to shrink. And in our analysis, we thought, OK, we have significant capital appreciation, here. There's all sorts of risk with this deal because let's say the deal doesn't go through with LVMH, then the bond would just go right back down to where it was. And we saw this as an excellent opportunity to take some chips off the table and achieve a very compelling 26% return.

[00:44:45.81] Now, when we then look at another bond on slide 22-- so investors can be as astute as possible and make a sound initial investment decision, and I believe we I believe we did on this bond. So this is the same grocer that we talked about before. We recommended this bond May 31st of 2019 at a price of $86.44. At the time the yield was 4.77%, so a fairly compelling yield. And over the next year, Treasury yields fell, the credit spread of this bond shrunk, and so it reached an all-time high of 122 in August of 2020.

[00:45:30.87] Now, at that point, we weren't ready to sell because we do like to maximize the return of every bond we recommend over as long of a period of time as possible. And so we decided to hold the bond. So we held it through 2020, we held it to 2021. And even at the end of 2021, it was still trading around 115. And that would have been the opportune time to sell because we would have had 30 points of capital appreciation-- really significant investment return. But at that point in time, there weren't very many compelling buys so we mistakenly decided to hold on to that bond. And then like the lion's share of all of their long-dated investment rate bonds, the bond got crushed. And so it went from 115 all the way down to 70.

[00:46:15.97] And the biggest problem with this bond is that it has a low coupon. And so, yes, the bond has recovered a little bit. So it recovered from 70 up to 80. And because Treasury yields are still volatile, we believe the bond is going to recover and get close to par, but we don't know exactly when that will be. But it's extremely important, especially when you're looking at a lower coupon bond such as this, to be very disciplined. Because it's going to take a while for the income to compensate the investor for the fall in the bond's price, here. And that was a mistake that we made on this bond.

[00:46:57.07] Now, we'll end on an up note. This is Albertson's of '29. So we made our first set of bond recommendations September 26th of 2017. This was in our first set of recommendations-- the Albertsons '29. So Albertsons is a large US grocer and the bond had fallen in price because Amazon announced that it was buying Whole Foods. Everybody thought, well, Albertsons is going to have all sorts of struggles because Amazon is just going to take over the world.

[00:47:28.75] What people forgot is that Albertsons is a really good company, and it competes day in and day out with some of the best grocers in the world. And at the time at a yield of north of 10%, but its leverage ratio was reasonable. And so we thought it was going to be a compelling buy. Over the intervening years, excellent financial performance, especially in the wake of COVID, like a lot of grocers. The bond hit an all time high of 120, but we still thought there was some upside because the rating agency has just got it wrong on this one because they still had it as single B when it should have really been investment grade, but they decided not to upgrade it.

[00:48:07.79] The bonds started trickling down, and we decided to sell it, I believe it was right around 109 or so where we decided to sell it because we said, all right, we've had a nice ride in this bond. 2022 shaping up to be a difficult market, we need to ring the cash register on this and follow the adage that no one's ever gone broke taking a profit. And that's what we were able to do with this bond.

[00:48:29.92] RICHARD CARTER: Well, that's great, Steve. Congratulations on that [INAUDIBLE], and may you have many more. Well, I think that's a great point to wrap it up and hear from our audience. Thank you again for a very interesting and helpful presentation, Steve. I know we've got a lot of questions in the forum, here. So why don't we turn it to Jonathan and the team and let you take a few.

[00:48:54.68] JONATHAN LAMOTHE: Thank you so much, Richard. And again, thank you for everyone who joined us today and who submitted a question. We are doing the best we can to get to as many as we can on the back end. But we're going to try to answer as many as we can in the next 10, 9 minutes here. So, Richard, I want to start off with you. Our most popular question is, how should one-- if you can just briefly go into detail-- how can one purchase corporate bonds on Fidelity's website?

[00:49:20.76] RICHARD CARTER: Well, thanks, Jonathan. OK, Sure. It's hopefully a fairly reasonable process to begin to do that. As Steve was saying earlier, if you go to Fidelity.com and go under Research Fixed Income. So News and Research are across the top and then down to Fixed Income. You'll see our landing page, and in that landing page there's a grip, which is the yield table. And the yield table lists benchmark type of yields for 120 different data points. Those are listing by different bond types, like Treasury bonds, municipal bonds, and corporate bonds. And across the columns are different maturity dates. And that just gives you a sample of yields that are currently trading from our inventory of municipal bonds, Treasury bonds, and corporate bonds. So one way is just simply to click one of those yields that corresponds to a corporate bond, and you'll see a quick search. That's like a one-click quick search as to a sample of relevant-- it could be, for example, single A corporate bonds that have maturity of five years, that would be one of the ways.

[00:50:29.16] Another quick way is to say-- in the middle just above the table, there's a row of different product types. And once you go into the Bond tab and type one layer down, again, the different bond types are listed. And amongst them are corporate bonds. And there, we have really divided the world, as Steve was talking about, into investment grade and high-yield, or non-investment grade. And if you go into either one of those, then you have what's more familiar to people in terms of a Screener. So there, the selection can be quite precise. You could select by credit rating, you could select by maturity, coupon, whether you want callable bonds or callable bonds, et cetera. So the idea is to try and narrow it down, and then from that short list, you're looking at a sublist of the live inventory.

[00:51:19.83] So that's a quick high level-- it's again, News and Research, Fixed Income, Bonds and CDs, go to that landing page, hopefully that will help you. And if it's causing you any troubles and you're having a hard time, please feel free to reach out to our team of specialists. and that number's on the website as well. That's 1-800-544-54-- 5372. Sorry, I get that wrong. 544-5372.

[00:51:50.15] JONATHAN LAMOTHE: Thanks, Richard. Also too, for anyone who wants to get a live demonstration on how to search for bonds, there are some recorded webinars at Fidelity.com/on-demand that will have some rundowns of how to actually go through and search for some bonds. I want to switch it back over to the aspect of selling a bond-- we got a lot of questions on selling. How is the sale price of a bond that's currently owned, how is that calculated? Since we don't think they're very-- if you ever noticed, it's not very liquid. So how is that price determined and what does happen if there's not a bid on a bond that you want to sell?

[00:52:29.68] STEVE SHAW: Sure. So it's important to keep in mind that I would first disagree that there aren't available quotes. As I showed before on this slide, here-- on slide 18. So this is showing on these bonds that we recommended, it shows the number of bid quotes and offer quotes on these particular bonds. So you'll see this bond recommendation to. There were nine live bid quotes and seven live offer quotes. And on the offer side, this 1,000 just means that there was a million total quantity.

[00:53:01.82] So selling is just as easy as buying. And it's very different than, say, a municipal bond. Where municipal bonds, yes, you won't see a live bid side, you'll just see one offer side quote. And so being an active investor, from my perspective, is generally easier to do when you own individual corporate bonds, because it's more liquid. And the reason it's more liquid is because you've got a smaller universe with corporate bonds than you do in munis, and that's why you can generally trade in and out of corporate bonds. We don't recommend day trading, but you can-- once you decide to sell a bond, you can typically find a live bid price.

[00:53:50.30] JONATHAN LAMOTHE: Thanks so much, Steve. A lot of interest too in our comments, here, about the differences between the new issue market and the secondary market. Is there any distinct advantage to being or buying only in the new market versus the secondary or are there are opportunities in both?

[00:54:06.40] STEVE SHAW: So all of our recommendations are in the secondary market because, as I showed in a much earlier slide-- and I'll go back. Let's go back to this slide. So our bread and butter is finding bonds that are priced at a discount to their par value, and finding those bonds and recommending those bonds. And then ideally, exiting those bonds after there's been capital appreciation. It's not to say that there aren't good bonds in the new issue market, but when we make a new recommendation we make the recommendation every quarter after companies have filed their most recent quarterly financials. And so we have all that up to date information, and that's been our approach because we're looking to maximize the ultimate total return of the investment.

[00:54:57.05] RICHARD CARTER: I would just add if I could, Jonathan, just to say that we do offer on Fidelity.com a new issue a selection of corporate notes. As Steve was saying, there's not quite the same type of choice. We have anywhere between 10 and 20 available on a given month. Some of the advantages there might be for investors that there's no charge. We do charge $1 per bond for the transaction on the secondary market, there's no charge for a new issue*. And the new issue corporate notes we offer up priced at par. So they're very clean, if you like, in terms of the price, there's no accrued interest. So there's some merits there apart from the fundamentals, as well of those companies, which people are obviously free to evaluate. But Steve was saying, I think from an active point of view, this way of the secondary market comes in. And of course, all the new issue bonds eventually become secondary-- they're on the secondary market, as well.

* Minimum markup or markdown of $19.95 applies if traded with a Fidelity representative. For U.S. Treasury purchases traded with a Fidelity representative, a flat charge of $19.95 per trade applies. A $250 maximum applies to all trades, reduced to a $50 maximum for bonds maturing in one year or less. Rates are for U.S. dollar-denominated bonds; additional fees and minimums apply for non-dollar bond trades. Other conditions may apply; see Fidelity.com/commissions for details. Please note that markups and markdowns may affect the total cost of the transaction and the total, or "effective," yield of your investment. The offering broker, which may be our affiliate, National Financial Services LLC, may separately mark up or mark down the price of the security and may realize a trading profit or loss on the transaction.

[00:55:51.09] JONATHAN LAMOTHE: All right. Thank you, Richard and Steve. Last question before we wrap up. Actually, let's get to two because we're getting a lot of questions on how to download the presentation, Steve? Everyone loved this deck. So I just want to mention, if you do want to download the deck you saw as part of this presentation-- if are watching on a laptop or desktop device, there should be a blue button to the bottom right hand corner of your screen that says Download Today's Presentation, that way you can get an exact copy of what Steve has been presenting this entire time.

[00:56:19.53] Last question, how can an individual retail bond investor determine the risk of culpability on a corporate bond?

[00:56:28.71] STEVE SHAW: Sure. So it's important to break it into two different parts, here. With investment grade corporate bonds, those will generally have a call provision, which is called a make-whole call, and you'll see that on Fidelity. If a bond is a make-whole call that is a very favorable term for the bond investor because let's say a bond's due in 2040, if the company wanted to call that bond, it has to pay you the present value of all the future interest in principal payments from now to 2040. And if a CFO did that, he or she would be fired the next day. So any time you buy a bond that was initially investment grade, you're generally protected because those are what we refer to as make-whole calls. So basically, you can't really go wrong from a call risk standpoint.

[00:57:17.49] Where you can run into trouble is when you buy a bond that was typically initially issued by a high-yield issuer-- so below BBB. There will be a call schedule, and it'll tell you-- if you go into Fidelity, it'll indicate when the bond is callable on which dates. Now, if you buy a bond at 80 and the bond is callable at 103, in two years, that's no problem because that's not called risk because you're going to be getting a much higher price than you bought the bond at. Where you can run into problems is that if you buy the bond, at say, a significant premium to the par value, say, at 108. And then the bond is callable 103, that's when there's risk.

[00:58:04.19] Now, in Fidelity, it does show you the yield to worst or the yield to maturity. And Richard, you can clarify, but when it shows the yield to worse, that will show you the impact of if that bond does get called at the quote unquote "worst call date." So we'll show you what your risk is if you bought, let's say you buy a bond debt at 105 and it is callable, we'll show you what your yield would be if that bond got called before maturity.

[00:58:33.23] RICHARD CARTER: Does that put you off, Steve, recommending these bonds callable? Or do you just take it into account?

[00:58:37.76] STEVE SHAW: Well, here's the interesting thing. So a lot of it depends on what other bonds are available out in the marketplace. There are some bonds, for instance, there are a couple of oil and gas bonds that are on a recommended list that we've recommended right around par. They're callable at 103 or 104, but they're yielding somewhere between 7% to 10%. So they won't have the capital appreciation opportunity that a bond that's not callable. However, we try to balance that, and if there is a nice coupon, then that can sometimes get us comfortable with the call provision. But we would never recommend a bond at 108 or 109 if it was callable at 103 because there's just too much risk associated with that type of investment.

[00:59:23.48] JONATHAN LAMOTHE: Well, Steve and Richard, I think you guys could probably talk about this for a much longer than 60 minutes, but we are unfortunately out of time. Richard, thank you so much for posing the questions and being such a good sport with us. And Steve, thank you for the excellent presentation. Really appreciate it. A lot of good comments. If you do have further questions or something didn't get answered today about your fixed income investing strategy or bonds specifically, please reach out to us give us a call, reach out to your local branch, get with your local rep if you have a planning partner. We'll be more than happy to answer your question. So with that, we are out of time. But again, thank you so much, Steve and Richard, and we'll see you next time.

[01:00:01.67] RICHARD CARTER: Thanks so much everybody.

[01:00:04.26] JONATHAN LAMOTHE: Bye.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities.) Fixed income securities also carry inflation risk, liquidity risk, call risk, and credit and default risks for both issuers and counterparties. Unlike individual bonds, most bond funds do not have a maturity date, so holding them until maturity to avoid losses caused by price volatility is not possible. Any fixed income security sold or redeemed prior to maturity may be subject to loss.

When investing in corporate bonds, investors should remember that multiple risk factors can impact short- and long-term returns. Understanding these risks is an important first step towards managing them.\] **Credit and default risk** \- Corporate bonds are subject to credit risk. It’s important to pay attention to changes in the credit quality of the issuer, as less creditworthy issuers may be more likely to default on interest payments or principal repayment. If a bond issuer fails to make either a coupon or principal payment when they are due, or fails to meet some other provision of the bond indenture, it is said to be in default. One way to manage this risk is diversify across different issuers and industry sectors. **Market risk** \- Price volatility of corporate bonds increases with the length of the maturity and decreases as the size of the coupon increases. Changes in credit rating can also affect prices. If one of the major rating services lowers its credit rating for a particular issue, the price of that security usually declines. **Event risk** \- A bond’s payments are dependent on the issuer’s ability to generate cash flow. Unforeseen events could impact their ability to meet those commitments. **Call risk** \- Many corporate bonds may have call provisions, which means they can be redeemed or paid off at the issuer’s discretion prior to maturity. Typically an issuer will call a bond when interest rates fall potentially leaving investors with a capital loss or loss in income and less favorable reinvestment options. Prior to purchasing a corporate bond, determine whether call provisions exist. **Make-whole calls** \- Some bonds give the issuer the right to call a bond, but stipulate that redemptions occur at par plus a premium. This feature is referred to as a make-whole call. The amount of the premium is determined by the yield of a comparable maturity Treasury security, plus additional basis points. Because the cost to the issuer can often be significant, make-whole calls are rarely invoked. **Sector risk** \- Corporate bond issuers fall into four main sectors: industrial, financial, utilities, and transportation. Bonds in these economic sectors can be affected by a range of factors, including corporate events, consumer demand, changes in the economic cycle, changes in regulation, interest rate and commodity volatility, changes in overseas economic conditions, and currency fluctuations. Understanding the degree to which each sector can be influenced by these factors is the first step toward building a diversified bond portfolio. **Interest rate risk** \- If interest rates rise, the price of existing bonds usually declines. That’s because new bonds are likely to be issued with higher yields as interest rates increase, making the old or outstanding bonds less attractive. If interest rates decline, however, bond prices usually increase, which means an investor can sometimes sell a bond for more than face value, since other investors are willing to pay a premium for a bond with a higher interest payment. The longer a bond’s maturity, the greater the impact a change in interest rates can have on its price. If you’re holding a bond until maturity, interest rate risk is not a concern.

While it may seem appealing to look at bonds that offer higher yields, investors should consider those higher yields to be a sign of potentially greater risk. Below are some of the potential risks involved with high yield investing. **Default risk -** The risk of default on principal, interest, or both, is greater for high yield bonds than for investment grade bonds. **Credit risk** \- High yield bonds are subject to credit risk, which increases as the creditworthiness of the issuer falls. It's important to pay attention to changes in credit quality, as less creditworthy bonds are more likely to default on interest payments or principal repayment. **Business cycle risk -** High yield issuers typically have riskier business strategies and more leveraged balance sheets, exposing them to greater risk of default at times of a downturn in business conditions. **Call risk** \- High yield bonds are more likely to have call provisions, which means they can be redeemed or paid off at the issuer's discretion prior to maturity. Typically an issuer will call a bond when interest rates fall, potentially leaving investors with capital losses or losses in income and less favorable reinvestment options. Prior to purchasing a corporate bond, determine whether call provisions exist. **Make-whole calls** \- Some bonds give the issuer the right to call a bond but stipulate that redemption occurs at par plus a premium. This feature is referred to as a make-whole call. The amount of the premium is determined by the yield of a comparable maturity Treasury security, plus additional basis points. Because the cost to the issuer can often be significant, make-whole calls are rarely invoked. **Event risk** \- A bond's payments are dependent on the issuer's ability to generate cash flow. Unforeseen events could impact their ability to meet those commitments. **Concentration risk** \- Excessive exposure to a specific market sector within any asset class could put investors at greater risk. It's important to seek diversification across a wide range of issues and industries in order to reduce the negative impact of a default. **Equity correlation risk** \- The perception that high yield issuers may have trouble generating sufficient cash flow to make interest payments could make them behave like equities. In some cases, high yield bonds may fall along with equities during an economic or stock market downturn. This is a concern for investors using fixed income as a hedge against equity volatility. **Liquidity risk** \- High yield bonds that may have been easy to buy or sell when market conditions were calm can suddenly become very difficult to sell when volatility increases. Typically, the market for high yield bonds is less liquid than the market for investment grade or government bonds. **Interest rate risk** \- Although high yield bonds have relatively low levels of interest rate risk for a given duration or maturity compared to other bond types, this risk can nevertheless be a factor. As with all bonds, a rise in interest rates causes prices of bonds and bond funds to decline. Because credit and default risk are the dominant drivers of valuations of high yield bonds, changes in market interest rates are relatively less important. At the same time, a tightening in monetary conditions that usually accompanies a rise in the general level of interest rates may cause a lagging reaction by weaker credits because of their inability to find sufficient funding, which in turn weakens the balance sheet of the high yield entity. **Higher transaction costs** \- Due to a typically large spread between bid and offer prices, and higher transaction costs associated with less liquid securities, trading high yield bonds can be costly. **Research and monitoring demands** \- Current and accurate information can be more difficult to obtain for high yield bonds. Investors should conduct due diligence as they consider investment strategies and closely monitor the changing financial condition of the issuing company. **Foreign risk** \- In addition to the risks mentioned above, there are additional considerations for bonds issued by foreign governments and corporations. These bonds can experience greater volatility due to increased political, regulatory, market, or economic risks. These risks are usually more pronounced in emerging markets, which may be subject to greater social, economic, regulatory and political uncertainties.

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Past performance is no guarantee of future results.

Diversification does not ensure a profit or guarantee against loss.