Corporate Bond Investing for Total Return

Steve Shaw
Founder & President, BondSavvy

steve@bondsavvy.com

August 5, 2021
Past performance is no guarantee of future results.

The views expressed are as of the date indicated and may change based on market or other conditions.

Unless otherwise noted, the opinions provided are those of the speaker or author, as applicable, and not necessarily those of Fidelity Investments. The experts are not employed by Fidelity and no compensation was received from Fidelity for their services. Fidelity Investments is not affiliated with any other company noted herein and doesn’t endorse or promote any of their products or services.

Please determine, based on your investment objectives, risk tolerance, and financial situation, which product or service is right for you.

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. Any fixed income security sold or redeemed prior to maturity may be subject to loss.

References to individual securities are for illustrative purposes only, and should not be construed as recommendations or investment advice.

The third-party trademarks and service marks appearing herein are the property of their respective owners.

Fidelity Brokerage Services LLC, Member NYSE, SIPC, 900 Salem Street, Smithfield, RI 02917

843662.4.0
Let’s Stop Putting Bonds in a Box

Many investors believe:

1) Bonds are purely income investments
2) When rates rise, all bond prices go down
3) Bonds are good for ‘ballast’ but little else

BUT….

Individual corporate bonds can achieve three key investment objectives, whereas other investments often cannot

<table>
<thead>
<tr>
<th>Stocks</th>
<th>Bond Funds</th>
<th>Individual Corporate Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Generate Income</td>
<td>Green</td>
<td>Green</td>
</tr>
<tr>
<td>Preserve Capital</td>
<td>Red</td>
<td>Green</td>
</tr>
<tr>
<td>Drive Growth</td>
<td>Green</td>
<td>Green</td>
</tr>
</tbody>
</table>

For illustrative purposes only
Creating opportunities to increase bond total returns requires investors to:

1) **Be flexible:** Be willing to consider a variety of bonds across the credit and maturity spectrum

2) **Find value:** Identify bonds with compelling values relative to their price, yields, and issuer’s financial strength

3) **Monitor:** Monitor bond price performance and issuing company’s financial performance to determine whether to buy more, hold, or sell

4) **Exit:** Sell bonds prior to maturity when their relative total return opportunity is no longer compelling
Wide Pricing Disparity Can Create Opportunities

• In this recent bond search, the substantial majority of corporate bonds were trading between 80 to 150, which creates opportunities to maximize capital appreciation.

• Investment-grade corporate bonds often have greater upside potential than high-yield corporate bonds given the latter’s call provisions and shorter maturities.

Price Distribution from May 16, 2021 Corporate Bond Search on Fidelity.com

Investment Grade – 8,018 bonds

<table>
<thead>
<tr>
<th>Offer Price</th>
<th># Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;=150</td>
<td>55</td>
</tr>
<tr>
<td>&gt;=125&lt;150</td>
<td>1,003</td>
</tr>
<tr>
<td>&gt;=110&lt;125</td>
<td>2,407</td>
</tr>
<tr>
<td>&gt;=100&lt;110</td>
<td>3,833</td>
</tr>
<tr>
<td>&gt;=95&lt;100</td>
<td>478</td>
</tr>
<tr>
<td>&gt;=90&lt;95</td>
<td>192</td>
</tr>
<tr>
<td>&gt;=85&lt;90</td>
<td>36</td>
</tr>
<tr>
<td>&gt;=80&lt;85</td>
<td>13</td>
</tr>
<tr>
<td>&lt;80</td>
<td>1</td>
</tr>
</tbody>
</table>

720 bonds (9%) (12.5%)

High Yield – 1,120 bonds

<table>
<thead>
<tr>
<th>Offer Price</th>
<th># Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;=150</td>
<td>1</td>
</tr>
<tr>
<td>&gt;=125&lt;150</td>
<td>59</td>
</tr>
<tr>
<td>&gt;=110&lt;125</td>
<td>249</td>
</tr>
<tr>
<td>&gt;=100&lt;110</td>
<td>133</td>
</tr>
<tr>
<td>&gt;=95&lt;100</td>
<td>72</td>
</tr>
<tr>
<td>&gt;=90&lt;95</td>
<td>20</td>
</tr>
<tr>
<td>&gt;=85&lt;90</td>
<td>8</td>
</tr>
<tr>
<td>&gt;=80&lt;85</td>
<td>10</td>
</tr>
<tr>
<td>&lt;80</td>
<td>10</td>
</tr>
</tbody>
</table>

243 bonds (22%) (5.3%)
Bond investors seeking to increase total returns should embrace and capitalize on pricing volatility
Bond Price Swings Can Create Compelling Opportunities

Long-dated investment-grade bonds such as this Apple ‘45 bond can be volatile, including when it fell in the wake of COVID-19 and the Q4’20/Q1’21 spike in long-term Treasury yields.

US Treasury Yields

Apple 3.45% 2/9/45 Historical Prices

Source: US Treasury market data. Yields are from 12/31/19 through 7/27/21.

Source: FINRA market data. Prices from 12/31/19 through 7/27/21.

* Bond rating is as of July 14, 2021. Financial metrics are as of March 27, 2021 and are BondSavvy calculations based on information contained in Apple's SEC filings.
Lower Price Volatility of Large Bond Index Funds

Capital appreciation in large bond index funds is typically limited since their holdings of thousands of bonds can reduce pricing volatility.

US Treasury Yields

Source: US Treasury market data. Yields are from 12/31/19 through 7/27/21.

Vanguard Total Bond Market Index Fund (VBTLX) Performance

Key VBTLX Metrics*

- # Bonds: 10,110
- Size ($BB): $307
- Avg Maturity: 8.5 yrs

Source: Nasdaq market data. Prices from 12/31/19 through 7/27/21.

* Data are per the Vanguard.com website and are as of May 31, 2021.
Many Bonds Are *Not* Sensitive to Changes in Treasury Yields

High-yield corporate bonds, such as this L Brands ‘35 bond, are generally not sensitive to changes in Treasury yields, as the L Brands bond price increased when long-term Treasury yields surged.
What Makes Corporate Bond Prices Move?

Since BondSavvy recommended the Albertsons ‘29 bond in Sept ‘17, it has increased in value for reasons different than the price increase of the Apple ‘45 bond.

Select Differences Between Investment Grade and HY Bonds**

<table>
<thead>
<tr>
<th></th>
<th>Investment Grade</th>
<th>High Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Spread as Proportion of YTM</td>
<td>Smaller</td>
<td>Larger</td>
</tr>
<tr>
<td>Maturity when Issued</td>
<td>30+ Years</td>
<td>5-10 Years</td>
</tr>
<tr>
<td>How Quoted on Institutional Desk</td>
<td>Credit Spread</td>
<td>Dollar Price</td>
</tr>
</tbody>
</table>

* Pricing sourced from Fidelity.com and FINRA market data.  ** Differences shown are general in nature and can vary from bond to bond.
We look to own a variety of bonds in Groups 2-4 that can achieve strong total returns

<table>
<thead>
<tr>
<th>GROUP 1</th>
<th>GROUP 2</th>
<th>GROUP 3</th>
<th>GROUP 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-Term Investment Grade Bonds</td>
<td>Long-Term Investment Grade Bonds</td>
<td>“Fallen Angels*”</td>
<td>High Yield Bonds with Near-Term Call Dates</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Feature</th>
<th>GROUP 1</th>
<th>GROUP 2</th>
<th>GROUP 3</th>
<th>GROUP 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upside Potential</td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="Green" /></td>
</tr>
<tr>
<td>Yields</td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="Green" /></td>
</tr>
<tr>
<td>Interest Rate Risk</td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="Red" /></td>
<td><img src="#" alt="Yellow" /></td>
<td><img src="#" alt="Green" /></td>
</tr>
<tr>
<td>Credit Risk</td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="Green" /></td>
<td><img src="#" alt="Yellow" /></td>
<td><img src="#" alt="Yellow" /></td>
</tr>
</tbody>
</table>

*“Fallen Angels” are bonds that were previously rated investment grade (at least Baa3 / BBB- by Moody’s and S&P) but were subsequently downgraded to below investment grade.*
A Longer-Term Outlook Can Provide Comfort to Those Investing in Long-Term Investment Grade Bonds

- Investors don’t need to predict where the Treasury market will be at a precise period in the future
- Since 2007, peak-to-trough periods have ranged from 5 months to 28 months
- If Treasury yields spike immediately following an investment, all is not lost:
  - We can purchase more of the same bond at a better price
  - At some point, there should be another reduction in Treasury YTMs, which should bolster the value of long-term investment-grade corporate bonds

* Source of yield data points is US Treasury Department data. Data are from Jan 2, 2007 through July 15, 2021.
HOW CALL PROVISIONS IMPACT INVESTMENT DECISIONS
**Bondholder-Friendly Make-Whole Call Provisions**

- Investment-grade corporate bonds such as the Apple ‘45 bonds typically have ‘make-whole’ call provisions.
- While these bonds are technically “continuously callable,” the issuer would have to pay the present value of all future interest and principal payments to effect the make-whole call.
- Given their high cost, issuers seldom invoke make-whole calls.
  - For these bonds, YTM and yield to worst (YTW) are equal, which removes upside constraint.
- When Fidelity customers click “View Schedule” for make-whole bonds, they will see no specific call dates or prices.
Bondholder-Unfriendly Call Schedules

- Most high-yield corporate bonds, on the other hand, are subject to specific call schedules.
- These callable bonds do not have a make-whole call but rather can be called at specific prices and on specific dates.
- Upon clicking “View Schedule,” investors will see when and at what prices the bond may be called.
- If the bond’s price goes above the next call price, the bond’s YTW will fall below the YTM, which caps the upside on callable bonds.
How To Incorporate Call Provisions Into Investment Decisions

1) Purchase price vs. next call price
   • Onerous call provisions can filter out investments that are otherwise compelling

2) Yield gain vs. call price ceiling
   • If a callable high-yield bond offers a slightly higher YTM than an investment-grade bond, this can often not be worth it if the first call price is only slightly above the current price

3) Appreciated price vs. next call price
   • After making an investment, we closely monitor the issuer’s financial performance and the bond price relative to the call price when updating buy/sell/hold decisions
CASE STUDIES OF TWO RECENT BUY/SELL RECOMMENDATIONS
CASE STUDY
M/I Homes 5.625% 8/1/25

Key M/I Homes Metrics: Buy vs. Sell Date

<table>
<thead>
<tr>
<th></th>
<th>Buy Date</th>
<th>Sell Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date</td>
<td>3/15/19</td>
<td>1/11/21</td>
</tr>
<tr>
<td>Price*</td>
<td>95.98</td>
<td>103.15</td>
</tr>
<tr>
<td>YTM</td>
<td>6.42%</td>
<td>4.84%</td>
</tr>
<tr>
<td>Leverage Ratio**</td>
<td>3.2x</td>
<td>2.0x</td>
</tr>
</tbody>
</table>

BUY RATIONALE

• Relatively high yield for a bond issuer that had consistently solid operating performance and a strong balance sheet
• Capital allocation focused on growing the business rather than share buybacks and dividends

SELL RATIONALE

• While M/I Homes’ financial performance had been strong, the next call price was 102.813 on August 1, 2021
• This placed a ceiling on the bond, and better opportunities were available
• There was also the risk of a partial call, which would have been penal in this less-liquid bond

BUY RATIONALE

** Calculated based on the most recent financials available on the recommendation and sell dates.

TOTAL RETURN*

<table>
<thead>
<tr>
<th></th>
<th>M/I Homes '25</th>
<th>iShares HYG</th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
<td>18.20%</td>
<td>11.66%</td>
</tr>
</tbody>
</table>

* Price and total return calculations based on top-of-book offer price available on Fidelity.com at 1:00pm on 3/14/19 (plus a 0.1-point markup) and Steve Shaw’s Fidelity.com execution price at 1:32pm ET on 1/11/21.
**BUY RATIONALE**

- High credit spread relative to the bond issuer’s default risk and leverage
- We are big believers in buying long-term investment grade bonds at a discount
- Diversified our 9/26/17 picks to include a blue-chip wireless operator

**SELL RATIONALE**

- Revenues were flat and, given Verizon’s high capex and big dividend, we didn’t see a catalyst for an improved credit profile
- Also, we didn’t believe the credit spread could materially fall, as the Apple 3.85% ‘43 credit spread was 1.09% vs. 1.36% for Verizon ‘42

---

**Key Verizon Metrics: Buy vs. Sell Date**

<table>
<thead>
<tr>
<th>Date</th>
<th>Buy Date</th>
<th>Sell Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date</td>
<td>9/26/17</td>
<td>9/9/19</td>
</tr>
<tr>
<td>Price*</td>
<td>89.72</td>
<td>106.43</td>
</tr>
<tr>
<td>YTM</td>
<td>4.55%</td>
<td>3.44%</td>
</tr>
<tr>
<td>Credit Spread</td>
<td>1.82%</td>
<td>1.36%</td>
</tr>
<tr>
<td>Leverage Ratio**</td>
<td>2.5x</td>
<td>2.4x</td>
</tr>
</tbody>
</table>

---

**TOTAL RETURN***

<table>
<thead>
<tr>
<th></th>
<th>Verizon ‘42</th>
<th>iShares LQD</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL RETURN</td>
<td>27.01%</td>
<td>12.53%</td>
</tr>
</tbody>
</table>

---

* Price and total return calculations based on top-of-book offer price available on Fidelity.com at ~3:00pm on 9/25/17 (plus 0.1-point markup) and Steve Shaw’s Fidelity.com execution price at 3:57pm ET on 9/9/19.

** Calculated based on the most recent financials available on the recommendation and sell dates.
Other Factors We Consider When Recommending Bonds

- Revenue and earnings growth outlook
- Upcoming bond maturities
- Existence of financial covenants and covenant ‘elbow room’
- Capital allocation
- Likelihood of bond rating upgrade or downgrade
- Industry concentration and trajectory
- Interest rate risk
- Seniority in capital structure
- Call schedule, if applicable
Thank you

Steve Shaw
steve@bondsavvy.com

(201) 748-9862

WWW.BONDSAVVY.COM
APPENDIX
Doesn’t inflation erode the value of bonds?

Key Recent Drivers of Long-Term US Treasury Bond Yields

Factors driving Treasury yields higher
- Record levels of US Treasury issuance
- *Higher inflation expectations*
- Increased appetite for riskier investments as economy recovers
- Reduced Treasury purchases by foreign investors

Factors driving Treasury yields lower
- Treasury yields still high vs. Germany and Japan
- Fed purchases of Treasurys
- Global growth outlook still mixed
- Q4 ‘20 and Q1 ’21 taxable bond fund inflows at highest levels since 2008
- *Technology and globalization have kept inflation low for decades*

• Believing “if inflation goes up, bond prices go down” oversimplifies how the bond market works

• Inflation is one of many factors that impacts US Treasury yields, as shown in the chart

• If rampant inflation ensues, it could hurt long-term investment grade bonds

BUT...

• Higher commodity prices have driven high yield bonds issued by oil & gas and other commodity-based issuers higher
BondSavvy Disclaimer

InvestorG2 LLC d/b/a BondSavvy is not registered as an investment adviser under the Investment Advisers Act of 1940, as amended (“Advisers Act”), or the securities laws of any state or other jurisdiction, nor is such registration contemplated. All opinions expressed by Steven Shaw and BondSavvy during this presentation are solely Shaw’s opinions and not those of Fidelity Investments.

Any screenshots, charts, or company trading symbols mentioned are provided for illustrative purposes only and should not be considered an offer to sell, a solicitation of an offer to buy, or a recommendation for the security.

As BondSavvy operates under the publishers’ exemption of the Advisers Act, the investments and strategies discussed in this presentation do not take into account an investor’s particular investment objectives, financial situation or needs. In making an investment decision, each investor must rely on its own examination of the investment, including the merits and risks involved, and should consult with its investment, legal, tax, accounting and other advisors and consultants.

The information in this presentation is based on data currently available to Shaw, as well as various expectations, estimates, projections, opinions and beliefs with respect to future developments, and is subject to change. Neither Shaw nor any other person or entity undertakes or otherwise assumes any obligation to update this information.

There are risks inherent in investing in bonds, which may adversely affect the bonds’ investment returns. These risks include, for example, market decline, interest rate fluctuations, inflation, default, liquidity, and asset class risks. There is no guarantee that investors will be able to meet their investment objectives. Past performance is no guarantee of future results. Investors could lose all or part of their investment in a bond, particularly when investing in a high yield bond. Investing in bonds could also produce lower returns than investing in other securities. Investing in bonds does not constitute a complete investment program.