Step Ten (B)- Your Personal Investment Review Bonds & Commodities

Bonds Are Debt, Not Equities

Bonds are debt, a much more sophisticated form of a loan legalised into a security that can be publicly traded.

Par value.

A bond, issued generally in $1,000 increments, is a promise to pay back the principal (and interest) as listed on the offering certificate (namely, 100% - in this case $1,000) regardless of the purchase price or trading prices thereafter. You, as a creditor, with your purchase, have loaned cash to a company, a state, a municipality, or a country in return for the interest consideration and repayment of principal.

Bond investors (you) have no ownership stake, no long-term appreciation, but generally, purchasing a high-grade credit rated bond of a country, say United States (or any G7 country: Cana-da, France, Germany, Italy, Japan, the United Kingdom), means safety and assurance that your princi-pal will be returned to you.

Purchase price and non-correlation with par value

of a bond at issue may be exactly $1,000 (100%), but generally, is determined by market interest rates, fiscal strength and credit rating of the country or company issuing the bond. Note: Regardless of the purchase price, at bond maturity, you will receive the par value stated on the bond ($1,000) back - if, the country is considered a safe haven, high grade credit rating, and low investment risk.

A United States Treasury 30-year bond, or an Austrian government bond or an Argentinian government bond, regardless of the original issuance value or coupon interest rate listed, will command very dif-ferent prices in secondary trading markets.

At February 2020, for instance, a US 30-year bond or the Austrian bond price (the premium) will be significantly higher than par value due to very high credit ratings and country fiscal strength. The Ar-gentina government bond on the other hand is selling at an enormous discount to the par value of 100% as there is significant doubt that any investor will receive their entire principal, or any, returned to them. See Chart below.

Bond Coupon Rate

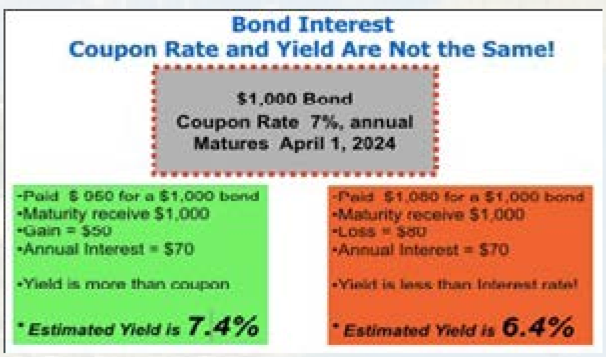
is the annual rate of interest to be paid, generally, in two semi-annual payments. The coupon rate does not change, but the yield on the bond will. See the example of a US 30-year Treasury bond below.

Bond Credit Ratings

Bonds are given credit ratings by rating agencies - actually, the issuer of the bond receives the rating. Great sovereign debt and fiscally sound companies will receive “investment grade” ratings from Triple AAA to Triple BBB, anything below that is considered higher risk downward to CCC to D - default. See chart below.

Bonds have An Inverse Relationship of Price to Yield

Bonds prices have an inverse relationship to capital market interest rates. When overall market inter-est rates climb, current bond prices decrease while yield increas-es. Conversely, when interest market rates decrease, bond prices climb, and existing bond yields drop.



In times of severe market stress as during the first and second quarter of 2020, safety and liquidity were the highest concerns. Triple AAA bond prices climbed astronom-ically in investor flight to safety while those below Triple BBB did not fare well, losing credit quality - some reclassified to CCC and D- junk.

Bond investors (you) never own any part of a company - you are just a creditor. You have no ownership stake, no long-term appreciation, but if you hold a high-grade bond to maturity, while not guaranteed, you will receive the principal back.

Example: United States 30-year bond cer-tificate issued November 16, 1981 at 14% coupon interest rate and $1000 Face Value with a maturity date of November 15, 2011.

Imagine! this interest rate of 14% covered the total cost of the bond in 5.14 years using the Rule of 72 - a terrific investment during a time of high inflation in the US.

Today’s environment - 30 year - bond in-terest rates are in the 2.5%-3% range with even lower yield!

Ah, the good old days….

Bonds have a definitive redemption date and may be called before maturity.

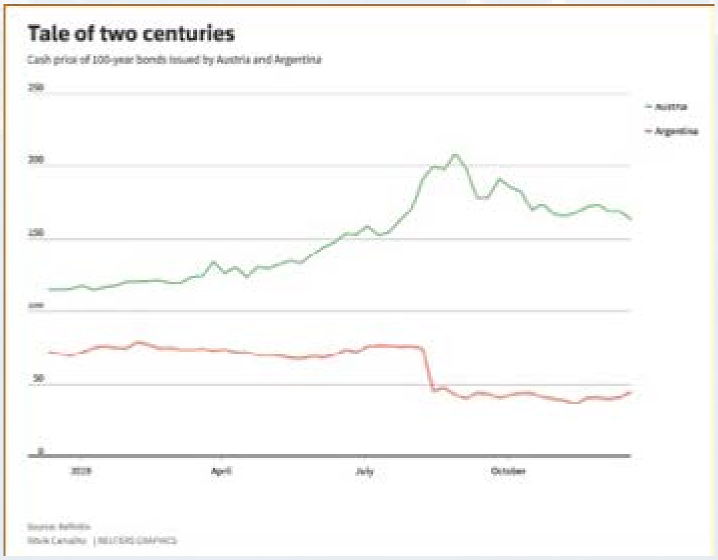
- Bonds may offer a convertible-to-stock feature, as well as a built-in put strategy. These are more complex strategies to be explored fully in The Bermuda Islander New Investment Primer - Book Two.
- High-grade bonds are considered less risky than stocks and are considered a portfolio diversifi-cation with a smooth-ing effect as bonds values, generally, are non-correlated with equity pric-es. When equities across the board tank, bond prices (high grade) generally, rise.
- High Credit Grade bonds (AAA) are con-sidered a safety net in tumultuous market conditions, political uncertainty, defensive investing, and so on. Then, investors sell out of more risky as-sets and buy high grade (US Treasuries considered the saf-est) driving up the prices (way up at times) - the bond yields drop in this case, too. Interest rates have little influence in frothy in-vestment markets; it becomes a flight to safety - where in the most basic sense, the investor knows that he/she will reduce risk and get all (or most) of his investment back.
- Low Credit Grade bonds (CCC) trend exactly the opposite. The more concern investors have about the ability of a country (or other entity) to repay the bond principal, the lower the asking price of the bond and the higher the yield.

Comparing High-Grade Bond versus Low-Grade Bond pricing.

Let's look at the example of the price dif-ferences between a 100-year bond of the Austrian govern-ment and the Argentina government as trading in secondary bond markets.

The Austrian bond is selling at more than 50% above its issuance price est. 150%, while the Argentina bond could not com-mand close to 100% at original issuance and is now selling (if anyone will buy it) at a discount of around 60% of original value.

By the way, the Argentina bond has a much higher interest rate, than the Austrian bond, but the price is significantly below par, and is worth far less.



This chart is a perfect example of why investors flee to low risk, low interest rates, high grade bonds - for safety and the as-surance that they will get their interest and principal back.

Argentina has defaulted on their government debt more than eight times in the last 100 years - not a good track record especially for beginning investors. And yet, investors will continue to purchase such bonds because of the lure of high interest rates.

See also Bond Characteristics Checklist in STEP 10 references section below.

Bermuda Government Bond Offerings (one example)

Our Bermuda government has issued numerous bonds listed in capital market exchanges (including the Bermuda Stock Exchange). We, the people resident in Bermuda, through our taxes are responsible to pay the interest on these bonds and at maturity (or before) return the original principal to the for-eign investor creditors.

One Bermuda Government bond offering listed on the Bermuda Stock Exchange, and the Luxembourg SE is shown below. The listing notes that a US$665million long 10-year bond offering was oversub-scribed - with the proceeds reducing higher bond interest offerings and a 200million guarantee to But-terfield bank. Net debt was increased by 189Million. http://cbonds.com/emissions/issue/268017

Government of Bermuda - 3.717% Senior Notes - Due 25 January 2027 - RegS

Listed Since: 2016/10/19.

Currency: BMD

CUSIP: G10367AD5.

ISIN: USG10367AD52

Offered in $200,000 increments

The net proceeds will be used by the Government of Bermuda ("the Government") to

i. fund the deficit for the current fiscal year (assumes 2016-2017),

ii. to repay US$200,000,000 of obligations under the credit facility with Bank of N.T. Butter-field & Son Limited and

iii. to pay the purchase price to holders of 5.603% Notes due 2020 and 4.138% Notes due 2023 that are validly tendered and accepted to be purchased by the Government pursuant to the terms of a partial cash tender offer being conducted by the Government concurrently here-with.

The notes will mature on January 25, 2027, unless earlier redeemed. The Government may redeem the notes, in whole or in part, at any time by paying the greater of the outstanding principal amount of the notes and a "make-whole" amount calculated by the Government. In addition, the Government may redeem the notes, in whole or in part, at any time on or after October 25, 2026 (three months prior to the maturity date of the notes) at a redemption price equal to 100% of the principal amount of notes to be redeemed, plus accrued and unpaid interest.

The notes have not been registered under the U.S. Securities Act of 1933, as amended (the “Securi-ties Act”), or the securities laws of any other jurisdiction. The notes will be offered only to qualified institutional buyers in the United States under Rule 144A of the Securities Act and to persons out-side the United States under Regulation S of the Securities Act.

The Notes will also be listed on the Luxembourg Stock Exchange for trading on the Euro MTF Mar-ket.

Commodities.: Economic Soft and Hard Goods

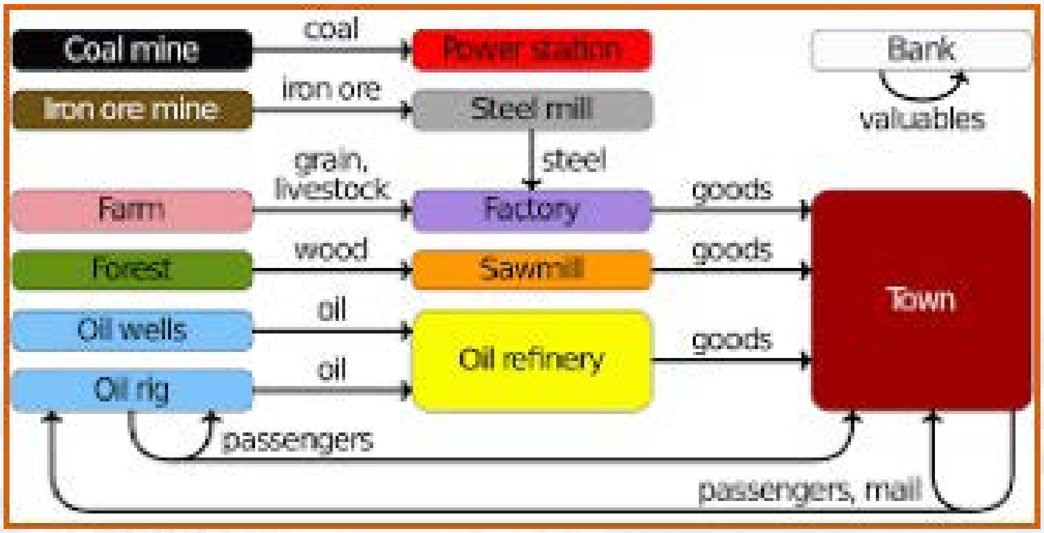
Commodities (gold, silver, crops, metals, livestock, oil, property, land, etc.) available on futures market trading platforms are more complicated, more volatile, often hedged or leveraged, and not as easy to understand, manage and obtain.

Interestingly, commodities were routinely traded thousands of years (witness the gold present in an-cient civilisations) before stock and bonds markets - a fact that makes sense when you consider the types of commodities and their essential functions in everyday life: energy, food, metals, and so on.

Commodities can be found supplied by companies, e.g. Exxon, DeBeers, and are also traded heavily with the use of futures and options contracts, ETFs, mutual funds (mining companies) and index funds. Commodities are usually considered a hedge against inflation, volatility, currency devaluation and the like. However, commodities themselves can be volatile: oil production down due to geographical con-flicts and trade wars (currently in March 2020), agriculture products affected by natural calamities and unpredictable weather patterns and so on.

A beginning investor may wish to avoid these products until the individual is comfortable with invest-ing concepts, including the many investment risks.

That, of course, does not translate when one has the ultimate goal of owning property, one’s own home! A personal investment, to be sure, rather than a capital market choice, but very, very important to an individual and family’s wellbeing.



Simple Commodities Flowchart commons.wikimedia.org

The Balance: Why Are Commodities More Volatile Than Other Assets? Andrew Hecht, Updated De-cember 12, 2019 https://www.thebalance.com/why-commodities-are-vol-atile-assets-4126754

Commodities: Basics, Research, Metals, Energy, Grains, and Others https://www.thebalance.com/commodities-4074037

How Commodities Trading Affect Food Priceshttps://www.thebalance.com/what-are-commodities-3306236