

Asset class: Bonds
Educational document for clients

Banque Bordier & Cie SCmA

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*This educational document provides a simple overview of bonds as an investment asset class, how they work, their sources of return and the main risks associated with them. It is intended for clients without financial expertise and **does not replace the official contractual documentation applicable to the financial instruments concerned.***

1. Introduction

Bonds are a traditional asset class widely used by investors seeking to generate regular income and diversify their portfolios. They are often perceived as less volatile than equities but nevertheless carry specific risks that are important to understand before investing.

2. What is a bond?

A bond is a **debt security** issued by a borrower, known as the issuer, to finance its activities. By purchasing a bond, the investor **lends money to the issuer**, who undertakes to pay interest and repay the principal on a specified date.

The issuer may be:

- a government,
- a local authority,
- a private or listed company,
- a financial institution.

The investor does not become the owner of the issuer, but **a creditor**.

3. Main characteristics of bonds

Bonds have several key characteristics that determine how they work, their yield and their risk profile:

- **Nominal value:** The nominal value corresponds to the amount of capital lent to the issuer when the bond is purchased. This is the basis on which the interest paid to the investor is calculated. Unless the issuer defaults, this value is repaid in full at maturity, regardless of the price at which the bond was purchased or resold on the market.
- **Coupon:** The coupon represents the interest paid by the issuer to the investor in return for the capital lent. It may be paid at regular intervals (usually annually or semi-annually) and may be:
 - fixed, with an amount known in advance,
 - variable, indexed to a reference rate,
 - or zero in the case of zero-coupon bonds.

The coupon rate directly influences the attractiveness and yield of the bond.

- **Maturity:** Maturity is the date on which the bond expires and the issuer repays the capital to the investor. Bonds can have very variable maturities, ranging from a few months to several decades. The longer the maturity, the more sensitive the bond is generally to interest rate changes.

- **Market price:** Before maturity, a bond can be bought or sold on the secondary market. Its market price may be higher or lower than its face value depending on several factors, including:
 - changes in interest rates,
 - the credit quality of the issuer,
 - the time remaining until maturity,
 - general market conditions.This price fluctuation may result in a gain or loss if the bond is sold before maturity.

- **Seniority:** Seniority determines the priority of payment of the bond in the event of the issuer's bankruptcy. Senior bonds are repaid first, while subordinated bonds are repaid only after senior creditors. Seniority directly influences the level of risk and, in general, the return offered to the investor.

4. Purpose of bonds

Bond investments can have several objectives:

- generating regular income,
- relative portfolio stability,
- diversification from equities,
- adjustment of the overall risk profile.

Bonds are often used as part of a cautious or balanced management strategy.

5. What are the main types of bonds?

Bonds can be classified according to different criteria:

- **By issuer**
 - ✓ Sovereign bonds (Governments)
 - ✓ *Corporate bonds*
 - ✓ Financial bonds (banks, institutions)

- **By coupon**
 - ✓ Fixed-rate bonds
 - ✓ Floating rate bonds
 - ✓ Zero-coupon bonds (no periodic interest payments)

- **According to risk**
 - ✓ **Investment grade bonds** (high credit quality)
 - ✓ **High-yield bonds**

6. Key players in the bond market

Investing in bonds involves several players, each of which plays a specific role in the functioning of the market and in protecting investors' interests:

- **Issuer:** The issuer is the entity that borrows funds by issuing bonds. It may be a government, a public authority, a company or a financial institution. In return for the capital received, the issuer contractually agrees to **pay interest** (coupons) according to predefined terms and to **repay the principal at maturity**. The financial strength of the issuer is a key factor in assessing the risk of the bond.
- **Investors:** Investors are individuals or legal entities that **purchase bonds**. By purchasing a bond, they become **creditors of the issuer**, not owners. Investors can be individuals, financial institutions, investment funds or pension funds. Their objective is generally to receive regular income and preserve their capital, subject to the risks associated with the issuer and the market.
- **Financial intermediaries:** Financial intermediaries, such as banks and trading platforms, **connect issuers and investors**. They are involved in particular in the initial issuance of bonds (primary market) and their subsequent trading (secondary market). They also contribute to market liquidity and may provide custody, settlement and information services.
- **Rating agencies:** Rating agencies assign **credit ratings** to issuers and, in some cases, to the bond issues themselves. These ratings aim to assess the **issuer's ability to meet its financial commitments**, taking into account its economic and financial situation. Although they are a useful analytical tool, ratings do not guarantee the absence of risk and must be supplemented by a more comprehensive analysis.
- **Supervisory authorities:** Supervisory authorities oversee the **functioning of bond markets** and ensure compliance with applicable rules on issuance, transparency and investor protection. The regulatory framework depends on the jurisdiction concerned and the type of issuer. Their role is to promote market integrity and investor confidence.

7. The life cycle of a bond

The life cycle of a bond is **determined at the time of issue** and is set out in a clear contractual framework. It comprises several successive stages, from the creation of the bond to the final repayment of the principal.

The first stage is **the issue of the bond** by the issuer. The issuer defines the main characteristics of the security, including the nominal value, coupon, maturity, repayment rank and applicable legal conditions. The bond is then offered to investors on the primary market.

After issuance, the bond enters its **holding phase**. During this period, the investor receives **interest coupons** at the specified frequency (annual, semi-annual, etc.). The bond can be held until maturity or traded on the **secondary market**, where its price may fluctuate depending on market conditions, interest rate movements and the issuer's financial situation.

At **maturity**, the bond expires. The issuer then **repays the principal** at its nominal value, except in the event of default or debt restructuring. Once the principal has been repaid, the bond ceases to exist and the life cycle is complete.

In certain specific cases, the life cycle may be modified, particularly in the event of **early repayment**, conversion (convertible bonds) or restructuring of the debt terms.

8. Bond yield structure

The yield on a bond comes mainly from:

- interest (coupons) received,
- changes in the market price if the bond is sold before maturity.

The yield depends in particular on:

- the coupon rate,
- the purchase price,
- the remaining term,
- interest rates,
- the credit quality of the issuer.

The net yield is influenced by the fees associated with the intermediary or investment vehicle used.

9. Risk structure of bonds

Investing in bonds involves several specific risks that are important to understand before making any investment decision. Although bonds are often perceived as relatively conservative instruments, they are not risk-free.

- **Credit risk:** Credit risk is the possibility that the issuer **will be unable to meet its obligations**, including interest payments or repayment of principal at maturity. In the event of default, the investor may suffer a partial or total loss of the capital invested. This risk varies depending on the financial strength of the issuer and the repayment rank of the bond.
- **Interest rate risk:** Bonds are sensitive to changes in interest rates. When rates rise, the market value of existing bonds tends to **fall**, as their coupons become less attractive compared to new issues. This risk is generally more pronounced for bonds with long maturities.
- **Market risk:** Bond prices may fluctuate depending on **general economic conditions**, investor expectations and movements in the financial markets. These fluctuations may result in gains or losses if the bonds are sold before maturity.
- **Liquidity risk:** Some bonds may be **illiquid**, particularly those issued by small issuers or on less active markets. In such situations, investors may find it difficult to sell their securities quickly or at a price close to their theoretical value.
- **Inflation risk:** Inflation reduces the **real purchasing power** of future cash flows. For fixed-coupon bonds, rising inflation can erode the real value of interest received and capital repaid at maturity.

These risks can be **partially mitigated** by appropriate diversification of issuers, maturities and bond types, as well as by careful selection of instruments. However, they cannot be eliminated entirely.

10. Key advantages and disadvantages

Advantages	Disadvantages
<ul style="list-style-type: none"> ▪ Regular income ▪ Visibility on future cash flows ▪ Portfolio diversification ▪ Priority repayment over equities 	<ul style="list-style-type: none"> ▪ Limited returns in a low interest rate environment ▪ Sensitivity to interest rates ▪ Risk of issuer default ▪ Less growth potential than equities

The above is a summary and non-exhaustive list of the main advantages and disadvantages of bonds.

11. How to invest in bonds

Bond investments can be made:

- directly, by purchasing individual bonds,
- indirectly, through funds or managed solutions.

The choice depends on the amount invested, the risk profile and the investment horizon.

12. How to liquidate a bond position

Liquidation can take place:

- at maturity, through repayment of the principal.
- before maturity, through sale on the secondary market.

The resale price depends on market conditions and the liquidity of the bond.

13. Bordier's bond offering

The Bank offers bond research services aimed at analysing fixed income and credit markets as well as issuers in order to identify investment opportunities tailored to its clients' profiles and objectives.

This approach is based on structured internal analysis combining a strategic view of the markets and issuer selection, with the aim of providing recommendations consistent with the risk level and investment horizon of the portfolios.

The emphasis is on rigorous selection, risk control and disciplined portfolio construction with a long-term perspective.

14. Important information

This document is provided for informational and educational purposes only and does not constitute personalised financial advice. Nor should it be interpreted as an advertisement or an offer of financial instruments. The content presented is neither exhaustive nor intended to cover all the characteristics and risks associated with the relevant category of financial instruments.

This information is intended to provide a factual overview and should not be used as the sole basis for investment decisions. Past performance is not indicative of future results, and the value of investments may fall as well as rise.

For general information on financial instruments, please refer to the Swiss Bankers Association's brochure entitled 'Risks inherent in trading in financial instruments', available on our website under the heading Legal & Compliance, Switzerland, FINSA, Guidelines Risks Involved in Trading Financial Instruments (published by SBA): <https://www.bordier.com/legal-and-compliance/switzerland/finsa/>.

If, for the relevant type of financial instrument, a key information document (KID) or a prospectus has been drawn up in accordance with the applicable legal provisions, these documents can be viewed and downloaded from our website under the heading Legal & Compliance, Switzerland, FINSA, Key Information Document (KID), at the following address: <https://www.bordier.com/legal-and-compliance/key-information-documents-kids/>

Before making any investment decision, investors are advised to carry out their own checks and carefully assess the potential risks. It is strongly recommended that they seek the assistance of a qualified financial adviser. The relationship manager is available to provide, upon request, any further information and to supply the relevant documentation. The Bank accepts no liability for decisions made on the basis of the information provided in this document.

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