



## Expert's Quote

“The stock market is but a mirror which provides an image of the underlying or fundamental economic situation. Cause and effect run from the economy to the stock market, never the reverse.” - **John Kenneth Galbraith**

## NSE at a glance (For week ended April 13th, 2009)

Index:	19,954.15	-0.6%
Cap:	N4.514trn	-0.76%
Volume:	1.7 bn	-37.86%
Value:	N9.75bn	-28.0%

# Advantages/Disadvantages of Corporate Bonds

In a typical emerging marketplace like Nigeria, Corporate bond is still a mystery to many investors. This is largely because companies seem to prefer equity as a more viable funding option than bonds due to the cost implications. Accordingly, the Nigerian bond market has been largely a mono-product market - only the Government bonds are traded. Though Corporate Institutions float bonds from time to time, information on them have not been very forthcoming to the public, since they are mainly marketed privately to institutional investors and high net-worth individuals. However, this trend would likely change in the immediate future. For one, the financial meltdown has affected investors' confidence in the equities market. The result of this low confidence has been the poor subscription level recorded on public offers floated by companies in the last few months.

Secondly, the illiquidity in the money market has also made funds from banks largely unavailable and where available, for a short term, which can hardly be used to fund long term projects. Since large corporations cannot do without adequate funding, attention would likely shift to Corporate Bonds.

Like everything else in life, corporate bond investment also has its upsides and downsides, though the upsides outweigh the downsides especially if your purpose for investing is steady income stream and capital preservation.

Unlike the stock market where some investors have some sort of awareness about how it operates, the bond market is still novel, consequently, it is essential to highlight some benefits that investors stand to gain in investing in bonds.

### Benefits of corporate bonds

For choosing to invest in bonds, you can take advantage of these benefits:

**Attractive yields.** The biggest advantage of corporate bond is the higher yield compared to government bonds. Corporate Bonds usually offer higher yields than comparable-maturity government bonds.

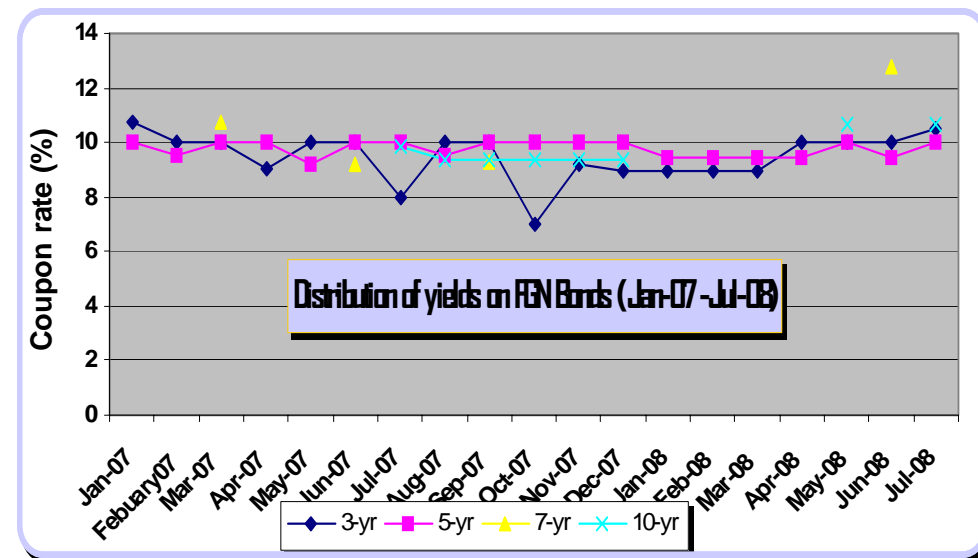
### Dependable Income

Corporate bonds pay interest semi-annually until maturity or until they are called. Investors will know when to expect payments and how much they'll be. As a result, they provide a fixed stream of income which makes them safer than stocks. Also, bond holders get paid by companies before stockholders. For example, companies are required to make interest payments to bondholders, but are not required to make dividend payments to stock holders. Another example of this is that if the company went insolvent, the bond holders would be the ones to get the proceeds from auctioning off the company's assets and the stock holders would get the residue.

People, who want steady income from their investments, while preserving their principal, should include corporate bonds in their portfolios.

### Flexibility

Corporate bonds provide an opportunity to choose from a variety of sectors, structures



no guaranteed income from stocks. However, stocks offer greater potential returns if its price increases. So in this way, bonds and stocks obey a fundamental rule of economics: with greater risk there is greater reward. So in periods of slow economic growth, bonds may look more attractive because it is unlikely stocks will provide good returns. In a period of expansion, however, stocks look much more attractive than bonds because you could make a lot more in much less time if your stocks go up.

2. Another disadvantage of corporate bonds over government bonds is that corporate bonds have more risk. While this does offer a higher yield in return, if you are risk averse, you would view this as a disadvantage of corporate bonds.

This is where the biggest difference between corporate and government bonds

and credit-quality characteristics to meet your investment objectives.

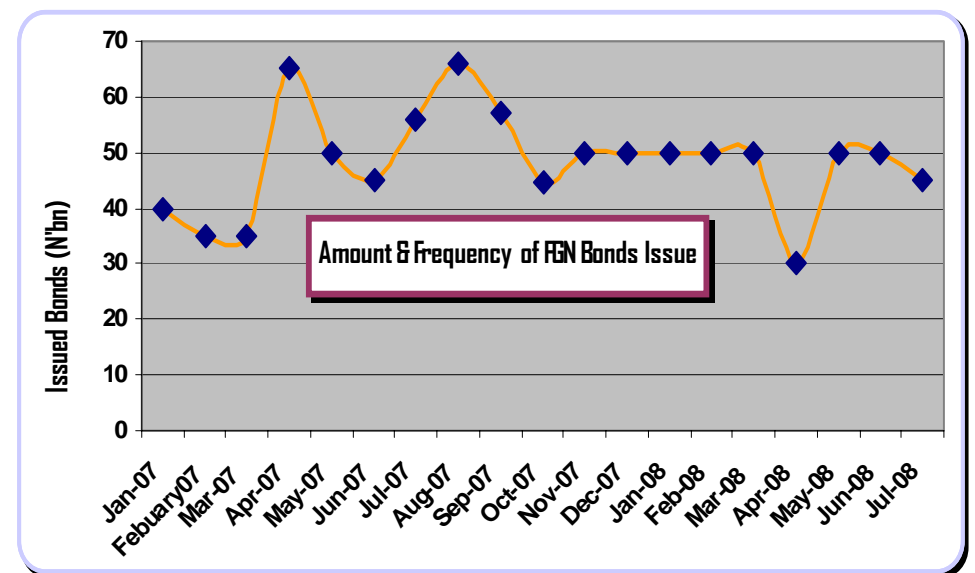
In advanced economies like US and Europe, investors have a wide range of corporate bonds to select from — ranging from specific industries to particular coupons, maturities and ratings. However, this advantage is not yet applicable to investors in Nigeria because of the low level of corporate bonds floated in the country, as

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awareness increase and more companies embrace bonds to raise funds, investors would ultimately enjoy such flexibility as currently enjoyed in the equities market.

### Safety

Corporate bonds are evaluated and assigned a rating based on credit history and ability to repay obligations. The higher the rating, the safer the investment as



measured by the likelihood of repayment of principal and interest.

### Diversification

Many people buy bonds to diversify their portfolios. Because there are so many different corporate bonds, you can structure your portfolio according to your particular investment strategy. However, your mix of bonds and stock will depend on your investment objectives.

### Liquidity

If you need cash you can sell your bonds any time prior to maturity in the secondary market. Some bonds trade more actively than others and may be easier to sell. Because bond prices and interest rates move in opposite directions, you may receive more or less than your original investment if you sell. Of course, if you hold your corporate bond until maturity, the issuer promises to pay back the full face value.

### Disadvantages of Corporate Bonds:

The disadvantages of Corporate Bonds are inherent in the risks involved. These risks when adequate measures are not taken to mitigate them when investing in bonds can turn out to be disadvantages. Some of them include:

1. As we said earlier, bonds are considered safer than stocks because they offer a steady flow of income while there is

lies. Government bonds are considered to be the safest investments having basically no risk that the government will default on its loans. On the other hand, corporations can and do go bankrupt. Because of this, corporate bonds are considered riskier than government bonds.

3. Because bonds are a fixed investment, they may not offer protection against inflation changes within an economy. If the interest rates on a bond investment are low and inflation increases more than average or expected, the investor has the potential to lose purchasing power within their portfolio.

4. The prices of bonds are affected by fluctuations in interest rates within the economy. Bond prices move inversely to interest rates; when interest rates rise, bond rates fall and vice versa.

5. Some bonds are callable, meaning that the Issuer can redeem the bonds issued. This is common when interest rates decline, making it more favorable for the Issuer to refinance their debts. If this occurs, the investor would be forced to redeem their bond and replace it with a new one that potentially would have lower coupon rates. For an investor who is relying on this income for their lifestyle, this can be a substantial disadvantage.