

# MARKET INSIGHT

## Expert's Quote

Investors are going to look for capital protection, they are sick of all the hot shot advice to make money out of stocks. Capital protection remains the global objective as I see it. This is not protection from the eroding effect of inflation but from total loss of capital in unstable markets... Clive Roffey

## NSE at a glance (For week ended March 23rd, 2009)

Index:	31,357.24	-2.04%
Cap:	N6.936trn	-2.04%
Volume:	191.9 m	+10.43%
Value:	N1.29bn	-14.8%



# Introducing Bonds as viable investment option

The first thing that comes to most people's minds when they think of investing is the stock market. After all, stocks are exciting. The swings in the market are scrutinized in the newspapers and even covered by TV newscasts. Stories of investors gaining great wealth in the stock market are common.

Bonds, on the other hand, don't have the same appeal. So little is known about

while governments need money for everything from infrastructure to social programmes. The challenge large organizations run into is that they typically need far more money than the average bank can provide. The solution is to raise money by issuing bonds (or other debt instruments) to a public market. Thousands of investors then each lend a portion of the capital needed.

Development Loan Stock, States and Local Government bonds.

2) Corporate Bonds: These are issued by corporate organizations.

A company can issue bonds just as it can issue stocks. Large corporations have a lot of flexibility as to how much debt they can issue: the limit is whatever the market will bear. Generally, a short-term corporate bond is less than five years; intermediate is five to 12 years, and long term is over 12 years. Last year, the maturity profile of government bond was extended to 20 years.

In many cases, corporate bonds are backed by a mortgage on part or all of the corporation's property. These are called mortgage bonds. Those that are backed only by the general credit-worthiness of the corporation issuing the bonds are called debentures.

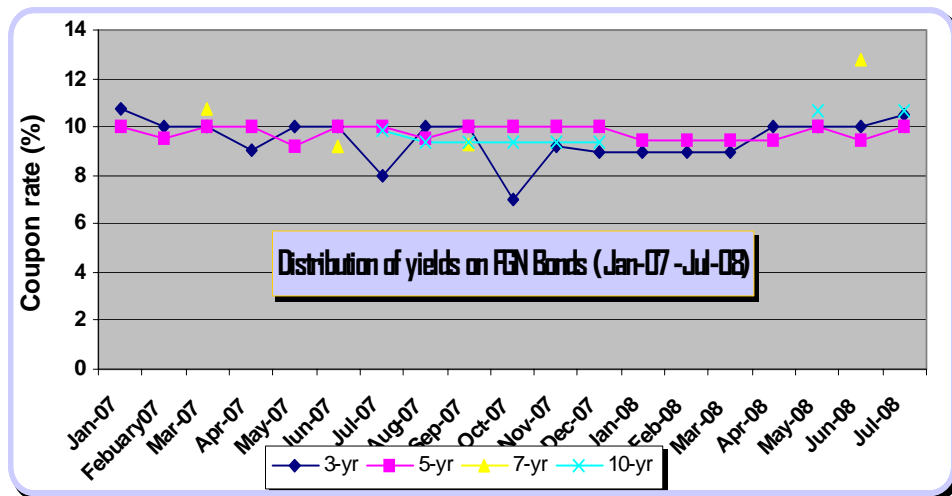
Some bonds require that the borrower set aside a certain amount of money each year to repay the loan. This money makes up a sinking fund.

Bond issues are ideally suited for financing the acquisition of durables, expensive long term assets such as buildings, real estates, machinery and

purchasing equity (stock) an investor becomes an owner in a corporation. Ownership comes with voting rights and the right to share in any future profits. By purchasing debt (bonds) an investor becomes a creditor to the corporation (or government). The primary advantage of being a creditor is that you have a higher claim on assets than shareholders do: that is, in the case of bankruptcy, a bondholder will get paid before a shareholder. However, the bondholder does not share in the profits if a company does well - he or she is entitled only to the principal plus interest.

Interest payment to Bond holders are usually paid first before dividend payouts to equity holders. Where no profit is made in a particular year, the bondholders' interest is carried over and paid together with the next year's, unlike equity holders who are not entitled to any dividend if the company makes a loss.

To sum up, there is generally less risk in owning bonds than in owning stocks, but this comes at the cost of a lower return.



the concept of bonds and that's known by avid investors not the average person.

Besides, bonds are much more boring - especially during raging bull markets, when they seem to offer an insignificant return compared to stocks.

However, all it takes is a bear market (what is currently being experienced globally) to remind investors of the virtues of a bond's safety and stability. In fact, for many investors it makes sense to have at least part of their portfolio invested in bonds.

In this edition we'll introduce you to the fundamentals of what bonds are, the different types of bonds and their important characteristics, while subsequent editions would shed light on how they behave, how they are purchased, and more.

The Bonds market in Nigeria is emerging into a formidable platform for investment. Since 1999, the federal government along with several state governments has issued bonds to generate capital to finance budget deficit, bridge long term funding gaps and finance long-term investments.

Federal Government is still sustaining the issuance of bonds through the Debt Management Office (DMO).

### What is a Bond?

A bond can be defined as a long-term debt instrument. It is an interest bearing certificate of debt or a written contract by the issuer to pay the lender a fixed principal amount at a stated future date and a series of interest payment at semi-annual or annual rate until the bond matures.

Just as people need money, so do companies and governments. A company needs funds to expand into new markets,

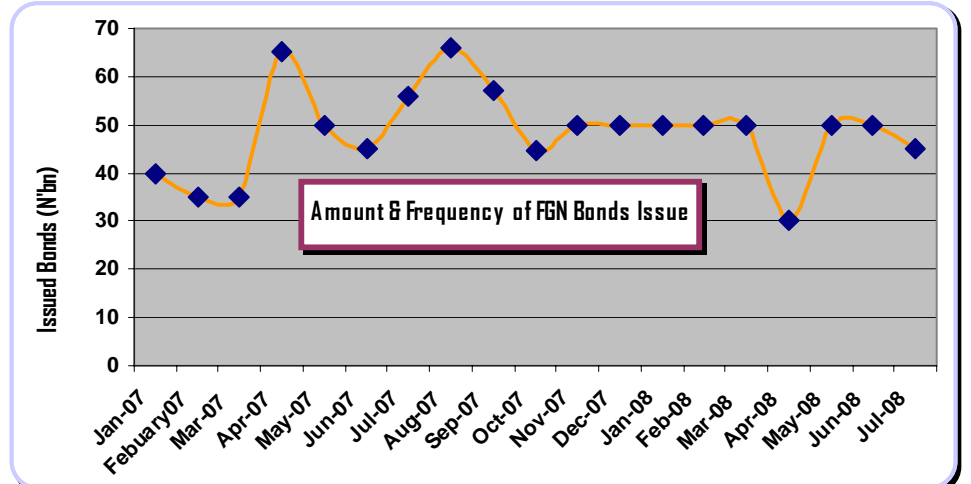
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A bond is nothing more than a loan for which you are the lender. The organization that sells a bond is known as the issuer. You can think of a bond as an IOU given by a borrower (the issuer) to a lender (the investor).

### Types of Bonds

There are two broad types:

1) Public Bonds: Those issued by government and governmental bodies including Federal Government



equipments etc. The cost of these assets is borne as the benefits from them are received. Thus, governments, state and local need not place a heavy immediate burden on the tax-payer for financing such viable projects as stated above. Government and corporate bonds are actively traded on the floors of Nigerian Stock Exchange (in Lagos, Port Harcourt, Onitsha, Kaduna and Ibadan).

Corporate bonds are characterized by higher yields because there is a higher risk of a company defaulting than a government. The upside is that they can also be the most rewarding fixed-income investments because of the risk the investor must take on. The company's credit quality is very important: the higher the quality, the lower the interest rate the investor receives.

**Difference between Bonds and Stocks** Bonds are debt, whereas stocks are equity. This is the important distinction between the two securities. By

### Bond Features

**Indenture:** This is a contract between a firm that issues long term debt securities and the lenders. It details the nature of the debt issue, specifies the manner of repayment of principal and interest, and lists restrictions placed on the issuing body in restrictive agreements.

**Trustee:** These could be banks or a Trust Company contracted by the bond holders to be dealing on their behalf with the debt issuer. **Call:** This is an optional retirement provision that permits the issuer to redeem or call back a debt prior to its maturity at a call price.

**Conversion:** Some debt issues allow the holder to exchange the security for the company's common stock. These are some of the sweeteners in a bond issue

Other variations on corporate bonds include convertible bonds, which the holder can convert into stock, and callable bonds, which allow the company to redeem an issue prior to maturity.