10 Things You Should Know About Bonds

A high-level look at this wide-reaching investment asset class.

1. **What is a bond?** A bond represents a loan from an investor to a government or company. These entities issue debt to finance their operations and promise to repay investors the full amount, plus interest, in a specified time frame (typically ranging from one month to 30 years).

2. **More than one purpose:** Different types of bonds have different characteristics, which helps them serve varying roles in a portfolio. The most common roles are helping to dampen volatility from equities and potentially providing income, preserving capital, or hedging inflation.

3. **The word "bond" is a big umbrella.** There are many types of bonds, from the governments of countries—in the US, other developed nations, and emerging markets—to government agencies and local townships. Corporations can issue bonds, too, the quality of which depends on their financial strength. Other bonds are backed by pooled securities, such as mortgages, or non real-estate items, such as student loans.

4. **What is a bond coupon?** A bond's coupon is the amount of annual interest paid. In most cases, the coupon is a fixed percentage of the bond's face value. For example, a $1,000 bond with a 3% coupon would pay $30 in interest per year.

5. **Most bonds are graded:** Third-party rating agencies each have their own systems, but they all assess how likely it is a bond will repay principal in full to the bondholder upon maturity. Generally, the lower the rating, the higher the risk and, therefore, the higher the interest paid.

6. **What determines a bond's price?** A bond purchased from an issuer costs its face value, also called par value. But after the initial purchase, a bond's price can fluctuate up or down on the secondary market, where bonds trade between brokers, based on market conditions.

7. **What is bond yield?** A bond's yield is the actual amount of return you could realize on it. Yield is inversely related to price: If a $1,000 bond is purchased at a 3% coupon and interest rates rose to 3.5%, that $1,000 bond's price would drop to $857. This keeps old and new bonds competitive: an $857 bond with a $30 coupon yields the same 3.5% as a new $1,000 bond issued with a 3.5% coupon.

8. **What is a bond's maturity?** Maturity is the length of the bond's term and can be measured in months, years, and even decades. If an investor holds a bond until maturity, its term ends and that's when the principal is repaid in full (unless the issuer defaults).

9. **All investments have risks, even bonds:** It's not a comprehensive list, but some of the most common risks for bonds include credit risk (issuer fails to repay investors at maturity) and interest-rate risk (bond prices rise or fall when interest rates change). Not all bonds are equally sensitive to interest-rate changes: the degree of sensitivity is called duration.

10. **How to get started investing in bonds:** Unlike stocks, bonds aren't publicly traded on an exchange. But investors can purchase them over the counter on a secondary market, through a broker, or, in the case of US Treasuries, directly from the government. There are also professionally managed mutual funds or exchange-traded funds that offer access to a wider variety of bonds and expert resources.

Major Fixed-Income Categories Ranked by Relative Risk

Fixed-Income Type	What It Invests In
US Treasuries	Government bonds backed by the full faith and credit of the US government; because these bonds are considered low risk, they pay a low relative interest rate
Mortgage-backed securities (MBS)	Mortgages are purchased from the banks that issue them and combined into a pooled investment
Asset-backed securities (ABS)	Bundles of non real-estate securities, such as credit-card receivables, student loans, and auto loans
Municipal bonds	Debt issued by a state, county, or town to finance capital expenditures such as road construction; often tax-free at the federal level but may be subject to state or local income taxes
Investment-grade (IG) corporate bonds	High-quality bonds issued by companies with solid financial footing; offer moderate interest rates in exchange for moderate risk
Global bonds	A bond traded outside the country/currency it originated from
Bank loans	Loans issued from banks to primarily below-investment-grade companies
Emerging-market debt	Debt issued by the governments of developing countries and corporations; potential for default and geopolitical concerns
High-yield bonds	Lower-quality bonds issued by corporations and countries; these bonds can be risky and offer a high interest rate to compensate investors for taking such risk

Risk order was determined by examining duration risk, credit risk, and performance volatility. Source: Hartford Funds.

To learn more about investing in bonds, talk to your financial professional.

Important Risks: Investing involves risk, including the possible loss of principal. • Fixed income security risks include credit, liquidity, call, duration, event and interest-rate risk. As interest rates rise, bond prices generally fall. • Foreign investments may be more volatile and less liquid than U.S. investments and are subject to the risk of currency fluctuations and adverse political, economic and regulatory developments. These risks may be greater, and include additional risks, for investments in emerging markets or a particular geographic region or country. • Municipal securities may be adversely impacted by state/local, political, economic, or market conditions. Although municipal securities are exempt from federal income taxes, investors may be subject to the federal Alternative Minimum Tax as well as state and local income taxes. Capital gains, if any, are taxable. • Investments in high-yield ("junk") bonds involve greater risk of price volatility, illiquidity, and default than higher-rated debt securities. • Mortgage-related and asset-backed securities' risks include credit, interest-rate, prepayment, and extension risk.

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