Corriere del Ticino 2011/10/06

LET'S TALK ABOUT...
FINANCIAL LEXICON EDITED BY THE SWISS ASSOCIATION OF ASSET MANAGERS

Risk & bonds

It may be useful to shortly recap the main points one has to keep an eye on when considering the evolution of the overall bond market or certain fixed income instruments. In ordinary times the main risk is related to increasing rates as a result of more restrictive monetary policies, which negatively affects standing issues. Nowadays, although inflation risks stay valid in perspective, the major critical factor is linked to issuers themselves, that is their ability to pay coupons regularly and reimburse principal in full at the due date (default risk). Then, the evolution of market price has to be monitored, and the related yield, which is inversely correlated, other things being equal, apart from the nominal coupon. For the traded securities – the so called secondary market – a significant increase in yield means more risk ahead, although speculative investors may be often pleased by that. The same is valid for newly-issued instrument – the primary market: the higher the yield that market participants require (or the issuer itself offers), the more critical the picture. For sovereign debt instruments the terms of their auctions are also significant, in terms of demanded volumes, ease of placement, besides offered rates of course. All such factors concur in determining the so much mentioned spread, it being the yield gap between a certain security and the homologous “risk free” one. Currently the “risk free” concept however is a pretty theoretical one and may just apply – with many reserves indeed - to the US Treasuries and German Bunds. Last to be considered is the so much disputed CDS-Credit default Swap, the amount of the “premium” an investor has to pay in order to secure the full and timely repayment of an issue at its due expiration date. So by monitoring yields, spreads and CDS’s levels it is possible to gauge the fever which affects the fixed income markets and their issuers at the moment.
We also remind a general rule according to which long maturities are riskier than shorter ones, so that the latter are more suitable at times of turbulences and uncertainties as the ones we are facing. *- GLT*