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## Spotlight on fixed interest investments

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If ever there was a single asset type given short-shrift by investors, it is the humble bond.

It may be a reaction to debt instruments being at the heart of the global financial crisis, or the fact that a liquid retail bond market has never been up and running in Australia.

More likely, competition among banks to provide ever higher yielding term deposits has simply put other fixed interest instruments in the shade.

It's understandable investors are ignoring the long-term government bond market, now paying about 5.25 per cent, but they are also avoiding higher yielding corporate bonds. When risk-free, five-year term deposits at some banks are paying more than 7 per cent, similar longer term fixed interest securities have little chance of gaining investor attention.

Corporate bonds represent just 0.26 per cent of total household financial assets, according to the Australian Securities and Investments Commission. It's not surprising. There are only 14 listed 'vanilla' corporate bonds, those with simple, easy-to understand structures.

Last month Primary Health Care sold about \$150 million of its Series A bond (ASX: PRYHA), but the take-up from retail investors was minuscule, despite the offer of a yield at close to 9 per cent.

Yet with sharemarkets showing volatility there is greater talk of inclusion of bonds in portfolios, which offer more stability than shares and some of the strongest yields available to income investors.

"The point people forget about bonds is that if shares are falling, corporate bonds won't fall by anything like as much," says Brad Newcombe, a director of fixed income broker FIIG Securities.

"Assuming an issuer doesn't go broke – and it's unlikely to happen to the banks – the investor will always get the face value of the bond back."

A win-win situation? Not always. Bonds can be tricky. There are listed and unlisted bonds, hybrids (which act like equities and can be redeemed at any time) and some which convert to shares at a set date. All of them will have different terms, yields and structures.

Those which are not listed are traded on a secondary market and only in \$500,000 bundles – hardly accessible to the average investor. FIIG, however, does have a direct bond service, offering bond 'bundles' for as low as \$50,000.

If you're investing in a bond you need to know where it ranks in the event of corporate collapse. Are they secured or unsecured? How does its debt rank with other debt? Are they worth the price the market is offering? Due diligence is essential. As a bondholder you are the lender, so why does the company need your cash and why is it paying over the odds to get it?

Bond pricing is paramount. As interest rates rise, bond prices increase. When NAB issued its listed Income Securities (ASX:NABHA) at \$100 face value more than 10 years ago, it was offering 1.25 per cent over the 90 day swap rate. As interest rates have increased, the floating rate offer has lost its attraction.

The issue price has now fallen to around \$82. You still get the \$100 face value at redemption, but the issuer has all the redemption rights. The yield is now just over 7 per cent, with no certainty of when the capital will be repaid.

The recent Primary Health Care issue redeems in 2015 – and it pays a fixed margin of 4 per cent above the 90-day bank swap rate, at quarterly intervals. It looks like a strong deal from a good company – but there has been confusion over where this debt ranks with other debt held by the company. Its bank debt amounts to about \$1 billion.

Tabcorp bonds, issued in May last year, have gained in price (reaching a recent high of \$107) because the bonds offered an attractive yield of between 8 and 9 per cent at a time when interest rates were considerably lower. It has since proved to be a popular issue.

Alan Dixon, managing director of financial planners Dixon Advisory, says income-oriented investors should be looking at quality term deposits as well as some of the ASX-listed instruments. He recommends NAB Income Securities, the ANZ Preference Shares (ASX:ANZPA) and Southern Cross Airport Skies (ASX:SAKHA). He also recommends bond funds as they are automatically diversified and contain a very good spread of bond types and maturities from a range of issuers.

“A self-directed investor who takes the time to do the right homework can do very well in this market. Do it right and you can bump up your returns accordingly,” he says.