

A corporate bond is basically a loan from bond investors to the company issuing the bond. In return for the loan, the company pays interest to the investor. The issuance of corporate bonds is a source of funding for companies and an investment opportunity for bond investors.

Investment in corporate bonds typically involves a higher credit risk than investment in government and mortgage bonds. However, in turn, investors have prospects of yielding a higher return on these bonds.

Investment in a corporate bond issued by a company will usually be a safer investment than investment in shares issued by the same company, because as an investor (lending money to the company) you will be in a better position than a shareholder (co-owner of the company) in terms of recovering your money, should the company go bankrupt.

1. Opportunities offered by corporate bonds

Corporate bonds are relevant for investors who typically have a longer time horizon and an investment volume that enable them to invest in several corporate bonds in order to diversify the risk.

Investment in corporate bonds may be a good supplement to an equity portfolio, as corporate bonds generally deliver slightly lower, yet more stable, returns than equities.

2. Pros and cons

Pros	Cons
By assuming an extra risk, investor gets a return opportunity that is above that of conventional government and mortgage bonds.	Corporate bonds involve greater risks than investment in government and mortgage bonds.
Investor receives regular interest payments.	
Good supplement to an equity portfolio.	

3. Return

The total return depends on both the price movements during the investment period and the interest rate (coupon) on your bonds:

- The bond price may vary over time and influence your total return, if you sell the bond before it matures. Bond prices fluctuate concurrently with changes in the interest-rate level. The price will increase when the interest rate falls, resulting in a higher return. When the interest rate increases, the price will fall, resulting in a lower return.
- If you purchase a bond with a fixed coupon rate, you can expect fixed interest payments.

Benchmarks are typically used to measure whether a bond performance is satisfactory, by comparing the return on a bond with the return on a benchmark. A benchmark is a reference portfolio containing bonds which may be categorised by e.g. bond type, rating or maturity. When using benchmarks (e.g. interest rate benchmarks) in connection with government bonds, you must be aware of the risk that these benchmarks are, or may be, subject to national, international or other initiatives that may cause the benchmark to be calculated differently than they used to or may cease to exist.

Please see the banks website for fallback plans in connection with

benchmarks.

4. About risk

There are a number of risks to consider when investing in mortgage bonds:

- **Market risk:**
 - Bond prices fluctuate concurrently with changes in interest rates. This is especially true for fixed-rate bonds as the price on these bonds will rise when interest rates fall, and the price will fall when interest rates rise. The longer the bond duration, the more sensitive the price will be to changes in interest rates.
 - Relative to Investment-Grade corporate bonds, High-Yield corporate bonds will be more volatile, and so investors may experience significant price fluctuations.
- **Credit risk:**
 - When investing in corporate bonds, you cannot lose more than the amount invested, in the event that the company in which you have invested goes bankrupt.
 - A corporate bond may be secured, meaning the debt owed to the bond holders has been secured by a specific asset. In this way, in the event of bankruptcy, bond holders will generally have their debt repaid before investors holding unsecured bonds. In addition to collateral (if any), in the event of bankruptcy, it also makes a difference whether your bond ranks as senior or junior debt. Investors in senior debt will get their money repaid before investors in junior debt.
 - The price of a corporate bond will fall, as the probability increases for the bond issuer to not be able to fulfil its payment obligations as regards interest, instalments and debt outstanding. An increased risk of the company going into bankruptcy or being unable to pay interest and repay the debt outstanding on the bond loan means that investors will require a higher interest rate at purchase. Investors that already hold the bond will regard the interest rate hike on the bond as a price reduction.

Investors are compensated for this risk/uncertainty in the form of a higher rate on a corporate bond than e.g. by investing in a Danish government bond. This compensation is called a credit spread. An increased risk on a bond will result in an increased spread, meaning a higher rate on corporate bonds in comparison to government bonds.

- **Credit spread:**

There are two different categories within corporate bonds. They are Investment Grade (also known as High Grade) and High Yield. Investment Grade bonds are the safest bonds offering the lowest yields to maturity, while a higher risk is associated with High Yield bonds, which in turn offer higher yields to maturity. The category to which each bond belongs is determined by its rating. Rating is an assessment of the creditworthiness and expresses the probability that a company can and will pay the money owed to the investor.

Ratings are issued by credit rating agencies such as Moody's, S&P and Fitch, which apply different scales ranging from the best to the poorest rating. You should therefore always consider the rating of a bond - all types of bonds. There is typically a correlation between the credit rating of the issuer the risk, and the expected return. The lower the credit rating, the higher the risk and the higher the potential return.

It is important to note that ratings are solely a supplement for assessing the credit risk. Besides, a lot of corporate bonds have no rating. Whether there is a rating or not, you must assess the credit risk yourself before buying a bond.

- **Currency risk:**
 - If you invest in a bond denominated in another currency (for instance USD), you assume an exchange-rate risk. If the

exchange rate of the Dollar falls, the value of your bonds as measured in Danish kroner will fall.

- Liquidity risk:
- The liquidity of corporate bonds (how easily they can be converted into cash) is typically lower compared to e.g. government bonds. This means that it will be more difficult to sell a corporate bond when you want, as compared to a government bond. The liquidity varies from one corporate bond to another.
- Sustainability risk:
- Sustainability risk means an environmental, social or corporate governance event or condition that, if it occurs, may cause an actual or potential significant negative impact on the value of a corporate bond.

Environmental disasters that impact a company's actions, regulatory requirements to companies that do not conduct sustainable behaviour, a company's breach of labour rights and managerial neglect are examples of events or circumstances that have a potential negative impact on the value of a corporate bond.

Sustainability risks on issues from companies in Emerging Markets are believed to entail higher sustainability risks than issues in developed markets. Emerging markets are typically defined as countries that develop from developing economies towards becoming industrialised economies.

- Diversification:
- Investment in various corporate bonds with various issuers will reduce the risk. As with investment in shares, it is recommended to diversify the risk on several corporate bonds and hereby reduce the risk of incurring a loss.
- Bonds can contribute to stabilising the risk in a portfolio that contains both stocks and bonds.

5. What you should know before trading

Comparing bonds and stocks

Investment in bonds will typically entail a lower risk than investment in shares. When investing in a bond, you lend money to the issuer of the bond, which may be a company, a mortgage credit institution or a government.

When buying a share, you buy a stake in a company. For a bond, there is a fixed plan in terms of interest and instalments on the loan. When buying a share, you are basically not guaranteed any return. If a company goes bankrupt (defaults), bondholders will be first in line to get their part of what is left of the company, while shareholders will be last in line.

Tax

We offer general advice on tax issues. The tax rules differ depending on whether you trade as a private individual, as a personally owned enterprise, as a company or if you invest retirement money.

If you wish to learn about the specific importance of the tax rules for you, we recommend that you consult your accountant.

Expenses

There are costs associated with corporate bond investments. You will be informed about the expenses associated prior to making an investment in a bond:

- There are one-off costs associated with buying and selling bonds (brokerage). The brokerage fee is calculated as a percentage of the bond price of your bond order.
- When trading foreign bonds, a currency exchange fee will also be charged. In connection with certain foreign bonds, a stock exchange fee or turnover tax may be charged.
- In addition to trading costs, there are ongoing charges for the safekeeping of bonds in a custody account.

The relevant costs are stated on the Banks website.

Whether you trade via self-service systems or an adviser, you will always be informed of the expected one-off costs and on-going charges associated with a specific transaction.

Recommendation

We recommend that you contact your adviser if you have any questions in relation to the above information - or if you need any points clarified.