

www.rethinkyourdefence.com.au

AN ONLINE EDUCATIONAL RESOURCE EXPLAINING THE BENEFITS OF INVESTING IN FIXED INTEREST





ABOUT OUR WEBSITE

Investing is a confusing business at the best of times, let alone when there's lots of risk around.

"Rethink your defence" is a website created to explain what defensive assets are and how they play an important role in helping to protect your client's investment portfolio.

Within the site you'll find all you need to know about fixed interest – educational tutorials, investment outlooks, guides to the various sectors that make up the fixed interest market and much more.

Take a minute to join "rethink your defence" as a member. We'll then provide you with full access to all the materials contained on the site, including a regular investment newsletter. You can also earn CPD points by completing the educational tutorials.

Wise advisers know that defensive assets can play an important role in their clients' investment portfolios – to generate income and moderate risk. Fixed interest offers a great combination of these benefits.

With increased opportunities across all fixed interest sectors, your clients may find a haven in volatile times.

Isn't it time to rethink your defence?

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fixed interest fundamentals

Duration, Yield Curves, Benchmarks.

Like anything, fixed interest can appear confusing to the uninitiated. Here we explain the basics of fixed interest investing in an easy to understand manner, shedding light on some of the concepts and terms used. You'll be an expert in no time!

The screenshot shows a PIMCO website page with a green background and the text "Rethink Your DEFENCE". Below the title is a navigation menu with links: "WHY FIXED INTEREST", "FIXED INTEREST FUNDAMENTALS", "FIXED INTEREST SECTOR", "INFLATION", "NAVIGATING", and "NEWS, VIEWS & EVENTS". A sidebar on the left lists "FIXED INTEREST FUNDAMENTALS" with sub-links: "Duration", "Duration: The Most Common Measure of Bond Risk", "Different Duration Measures", "The Use of Duration Tools", "Fixed Duration Does Not Mean Equal Returns", "Yield Curve Basics", "Benchmark Basics", "Selecting a Benchmark", and "Inflation and its Impact on Investments". The main content area is titled "Fixed interest fundamentals" and includes a section "Duration: The Most Common Measure of Bond Risk" with a definition and a section "Different Duration Measures" with a definition and a list of "Curve Duration" points.

Yield

Yield refers to the annual return on an investment. The yield on a bond is based on the purchase price of the bond and the interest, or coupon, payments received. A bond's coupon interest rate is usually fixed, but the price of the bond fluctuates with changes in interest rates, supply and demand, time to maturity and the credit quality of that particular bond.

What is the Yield Curve?

The yield curve is a line graph that plots the relationship between yields to maturity and time to maturity for bonds of the same asset class and credit quality. The plotted line begins with the spot interest rate, which is the rate for the shortest maturity, and extends out in time, typically to 30 years.



What is the Yield Curve?

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The graph below is the yield curve for US Treasuries on 31 December 2002. It shows that the 10-year US Treasury bond was about 1.6 per cent while the yield on the 30-year Treasury was about 3.8 per cent.

The yield curve in action: US Treasuries, 31 December 2002



Selecting a Benchmark

A benchmark serves a crucial role in investing. Often a market index, a benchmark provides a starting point for a portfolio manager to construct a portfolio and directs how that portfolio should be managed on an ongoing basis from the perspectives of both risk and return.

What is a Benchmark?

In most cases, investors choose a market index, or combination of indexes, to serve as the portfolio benchmark. An index tracks the performance of a broad asset class, such as all listed stocks, or a narrower slice of the market, such as technology company stocks. Because investors track returns on a buy-and-hold basis and make no attempt to determine which securities are the most attractive, they represent a "passive" investment approach and can provide a good benchmark against which to compare the performance of a portfolio that is actively managed. Using an index, it is possible to see how much value an active manager adds and where – that is, through which investments – that value is added.

The following are among the most widely followed alpha indexes, or benchmarks:

Index	Origin	Description
RUS	U.S.	Price-weighted average of 30 large publicly traded U.S. "blue chip" stocks
PSE 500	U.S.	Market capitalization-weighted index of the 500 largest U.S. companies traded on the London Stock Exchange
Hang Seng Index	Hong Kong	Free float-adjusted market capitalization-weighted index of the 40 largest companies on the Hong Kong stock market
NASDAQ 100 Index	Global Equities	Free float-adjusted market capitalization index consist of 100 largest non-financial companies on the NASDAQ stock market
TOPIX	Japan	TOPIX leading index traded on the Tokyo Stock Exchange
S&P 500	U.S.	500 leading companies in the large-cap segment of the U.S. equities market
US Market Composite Bond Index	Australia	Capitalization-weighted index consisting of AUD government, semi-government fixed interest securities, as well as investment grade corporate debt

What is Duration?

Duration is the most commonly used measure of risk in bond investing. Duration incorporates a bond's yield, coupon, final maturity and call features into one number, expressed in years, that indicates how price-sensitive a bond or portfolio is to changes in interest rates.

Inflation and its Impact on Investments

Understanding inflation is crucial to investing because inflation can reduce the value of investment returns. Inflation affects all aspects of the economy, from consumer spending, business investment and employment rates, to government programs, tax policies, and interest rates.

fixed interest sectors

There are many different sectors within the fixed interest asset class, from corporate and inflation linked bonds through to the debt of emerging economies and more. This section of the website looks at each of these sectors in detail and outlines the benefits to issuers and investors, general characteristics and other useful information.

At a Glance

- Corporate bonds can add diversity to an investment portfolio, with returns depending on the economic environment, the credit rating of the bond issuer and the level of risk involved.
- Corporate bonds offer the potential for steady income and attractive yields, good liquidity and a ratings system that can guide investment asset choices.

Size of the Corporate Bond Market

Over the years the corporate bond market has attracted many investors seeking higher yields than those offered to government bonds and global bonds.

In the past 10 years, the global credit market has grown four-fold, with the Barclays Global Credit Index rising from US\$2.5 trillion to US\$8.4 trillion between 2000 and 2009. Over the same period, the US investment grade credit market grew from US\$1.3 trillion to US\$1.1 trillion.

The graphs below show the composition of the global credit market as at 30 November 2010.

Inflation-Linked Bonds

Investors, who are concerned about the impact of inflation can use inflation-linked bonds (ILBs) as an investment that may preserve their future purchasing power. As demand for ILBs has grown, so has supply. Issuers of global inflation-linked bonds continue to enter the market, seizing the opportunity to restructure their funding strategies to better match their revenue streams.

Credit Default Swaps

Credit default swaps (CDSs) are the most highly utilised credit derivative. In its most basic terms, a CDS is similar to an insurance contract, providing the buyer with protection against specific risks. Most often, corporate bond investors buy credit default swaps for protection against a default by the issuer of the corporate bond.

Mortgage-Backed Securities

Mortgage-backed securities (MBSs) are fixed-interest securities backed by pools of individual mortgage loans. If you have a mortgage on your home, there's a good chance your mortgage is now an asset backing up a publicly traded security. A high percentage of individual mortgages originated by banks and other lenders are ultimately pooled and used as collateral to issue mortgage-backed securities (MBSs), which are then sold to investors.

Breakdown of Global U.S. Market (US\$ Trillion)

Sector	Value (US\$ Trillion)	Percentage
U.S. Govt	84.0%	1.2%
Health, BPO	1.2%	1.2%
Energy	1.2%	1.2%
Telecom	1.2%	1.2%
Chemicals	1.2%	1.2%
Auto	1.2%	1.2%
Real Estate	1.2%	1.2%
Other	1.2%	1.2%

Growth of Global U.S. Market

Year	Value (US\$ Trillion)
1980	100
1985	150
1990	200
1995	300
2000	400
2005	500
2010	600

Common Credit Default Swap Transaction

Protection Buyer (Saves risk costs) → Payment (CDS & Credit Event) → Protection Seller (Saves to save credit rating, pay out on credit event, maintaining credit portfolio, Asset Credit Exposure)

What are the Emerging Markets?

The emerging markets term refers to those nations whose economies are developing or in the process of development. This includes most of all Africa, Eastern Europe, Latin America, Russia, the Middle East and the majority of countries that have yet to receive investment from major US financial markets. Some shared health of commodity trade to other nations have been a source of growth and manufacturing activity.

The Emerging Market Evolution

Over the 2000s, emerging markets offered a great fixed interest asset class offering a variety of government and corporate bonds, sovereign debt, structured debt, and other debt instruments, as well as a variety of equities.

Stack Quality Improves Market Capitalization across Credit Ratings in Emerging Markets

Emerging Market Global Index: Rating: Simplification

% of Index Market Capitalization

1990 1995 2000 2005 2010 2015

Corporate Bonds

When companies want to fund their businesses, they often turn to the corporate bond market. A company seeking to borrow money determines how much it would like to borrow and then issues a bond in that amount. Investors who buy corporate bonds are effectively lending money to that company according to the terms established in the bond offering.

Emerging Markets

Developing economies around the world, known to investors as emerging markets (EM), are maturing into key players in the global economy. This is opening opportunities for bond investors seeking the benefits of emerging market exposure, which can include potentially attractive yields, rising credit quality and diversification.

why fixed interest?

PIMCO offers a range of fixed interest products which encompass all sectors of the bond market. Feel free to contact us to discuss in more detail which fund may be the most suitable for your clients.

Global Bond Fund

The PIMCO Global Bond Fund is designed for investors who wish to have a broadly diversified exposure to international fixed interest markets. The Fund invests in government, corporate, mortgage and other fixed interest securities.

Diversified Fixed Interest Fund

The PIMCO Diversified Fixed Interest Fund is designed for investors who wish to have a broadly diversified exposure to both domestic and international fixed interest markets. The Fund invests in both domestic and global government, corporate, mortgage and other fixed interest securities.

Rethink Your **DEFENCE**

Investing in the most compelling bond investments in world class quality... the price of a bond or bond portfolio. The longer the duration, the more likely to be to changes in interest rates.

Earn CPD points

Past performance is no guarantee of future results. Investment shares will fluctuate and may be worth more or less than original cost... opinions of the manager and does not represent a recommendation of product. Such opinions are subject to change without notice. This article should not be considered investment advice.

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Four PIMCO High Quality Australian Focus Fund (Share): PIMCO

Fixed Interest
Mortgage & Real Estate

STANDARD

Calculator

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Australian Focus Fund

The PIMCO Australian Focus Fund is designed for investors interested in exposure to high quality Australian credit, whilst limiting their exposure to interest rate risk.

Australian Bond Fund

The PIMCO Australian Bond Fund is designed for investors who wish to have a broadly diversified exposure to the Australian fixed interest market. The Fund primarily invests in government, semi-government, corporate, mortgage and other fixed interest securities denominated in Australian and New Zealand dollars.

Global Credit Fund

The PIMCO Global Credit Fund is designed for investors who desire a well-diversified exposure to global non-government bond markets and greater long-term performance but with a greater appetite for volatility and risk.

Global Real Return Fund

The PIMCO Global Real Return Fund is designed for investors who recognise that their liabilities often are in real terms and wish to protect against a rise in inflation.

Funds managed by PIMCO and distributed by Equity Trustees include:

Fund Name	APIR Code	ARSN	Classification
PIMCO EQT Australian Focus Fund	ETL0182AU	132 708 402	Wholesale
PIMCO EQT Australian Bond Fund	ETL0008AU ETL0015AU	093 519 816	Retail
PIMCO EQT Diversified Fixed Interest Fund	ETL0016AU	093 519 558	Wholesale
PIMCO EQT Global Bond Fund	ETL0011AU ETL0018AU	093 530 486	Retail Wholesale
PIMCO EQT Global Credit Fund	ETL0019AU	093 519 352	Wholesale
PIMCO EQT Global Real Return Fund	ETL0020AU	105 379 413	Wholesale
PIMCO EQT Extended Markets Fund	ETL0017AU	100 167 511	Wholesale

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For further information please visit the Equity Trustees' website www.eqt.com.au or contact us at pimco@eqt.com.au or call 1300 555 511 to speak with a Business Development Manager in your state.

**register
now
for full
access**

The screenshot shows the PIMCO website's Member Login and Register interface. The 'Member Login' section has fields for Username and Password. The 'Register' section is titled 'Simply fill in your details below:' and includes fields for First Name, Last Name, Email Address, Company, Job Title, Password, and Confirm Password. There are also checkboxes for 'Are you a financial adviser?', 'Professional platform for super investments?', and 'Professional platform for non super investments?'. A checkbox at the bottom indicates 'I agree that the fee to confirm you have read our terms and conditions'. A 'Register' button is visible at the bottom right of the form.

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Rethink your defence

P I M C O

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