

Why You Should Invest in Corporate Bonds

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There are risks inherent in investing in bonds, which may adversely affect the bonds’ investment returns. These risks include, for example, market decline, interest rate fluctuations, inflation, default, liquidity, and asset class risks. There is no guarantee that investors will be able to meet their investment objectives. **Past performance is not indicative of future results.** Investors could lose all or part of their investment in a bond, particularly when investing in a high yield bond. Investing in bonds could also produce lower returns than investing in other securities. Investing in bonds does not constitute a complete investment program.

Don't Mess with...

Individual Corporate Bonds

- Contractual interest payments and return of principal
- Senior to common and preferred
- Financial covenants
- Held up when stocks collapsed in Q4 2018

Why own individual corporate bonds?

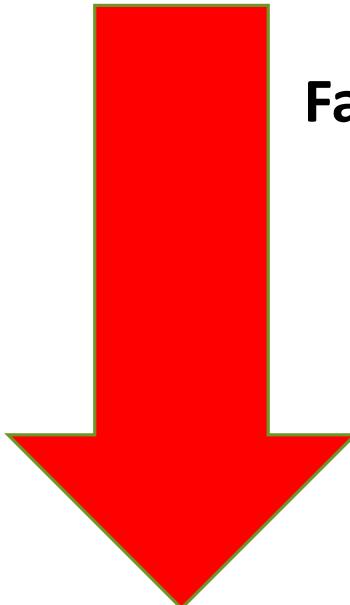
- **Higher potential returns than funds**
- **Match your risk and return objectives**
- **Lower cost of ownership than funds**
 - *Read recent BondSavvy blog post*
- **Not complicated once you learn the basics**

Individual corporate bonds are an important balance to stocks

JANUARY 3 PRICE PERFORMANCE

Apple Stock

Falls 10% from
\$158.34 to
\$142.09



Apple 3.45% '45 Bonds



Unchanged at 88.50



Bonds Can Do More Than You Think

Pinpointing value and selling bonds prior to maturity can enable investors to achieve high returns

<u>Bond</u>	<u>Bond Price: Investment Date vs. Sell Date</u>		<u>Investment Date YTM</u>	<u>Annualized Return Through Sale</u>	
Apple 3.850% '43 Purchased: 10/28/13 Sold: 5/9/18	85.07		95.32	4.8%	6.4%
Cablevision 5.875% '22 Purchased: 12/8/15 Sold: 1/9/18	79.25		99.12	10.1%	17.6%
Toys R Us 10.375% '17 Purchased: 2/12/16 Redeemed: 9/29/16	83.08		102.59	24.6%	54.2%

*Here's how **NOT** to invest in bonds*

Investor



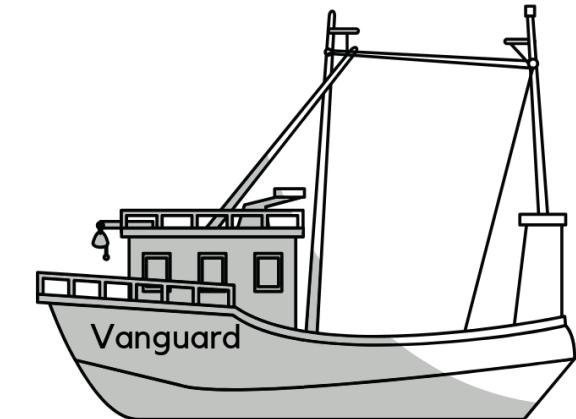
1% Fee

Financial Advisor



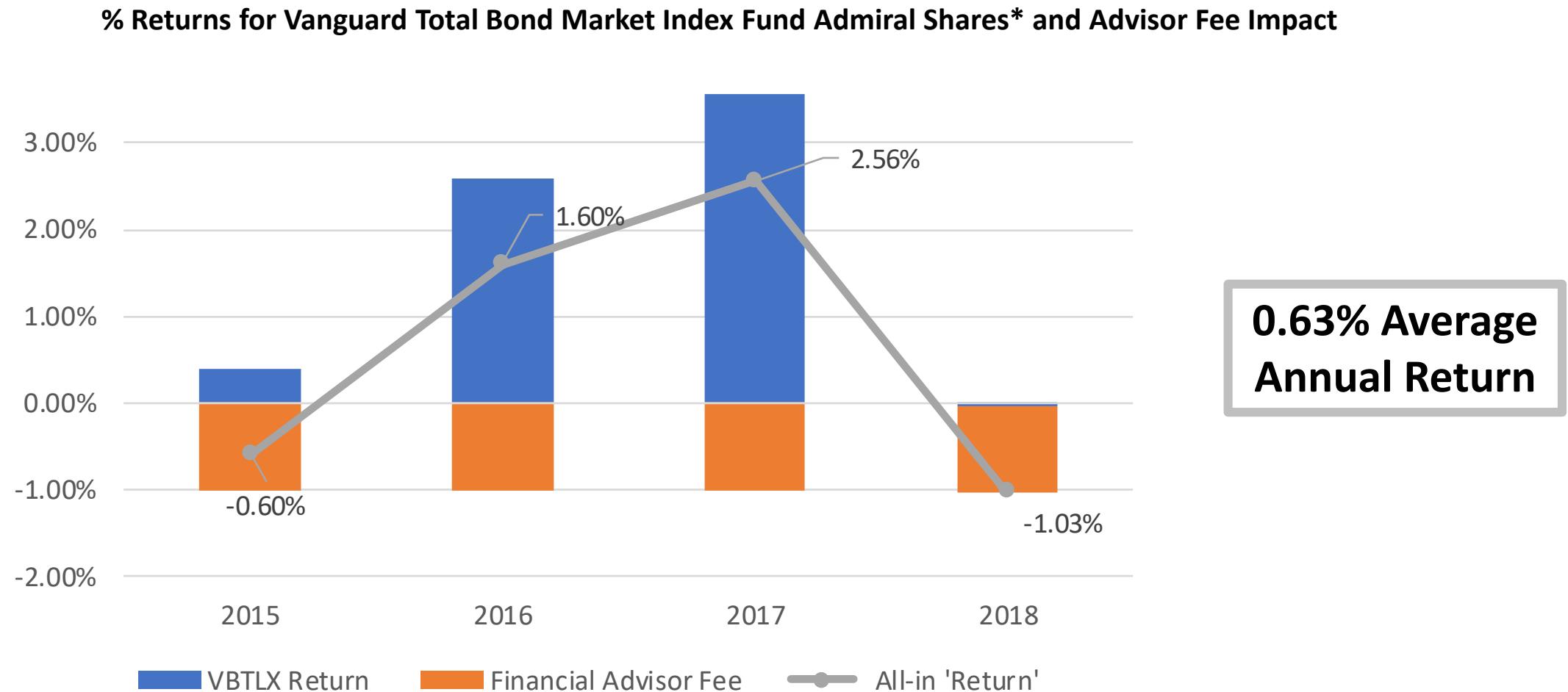
0.1-1% Fee

Bond Funds & ETFs



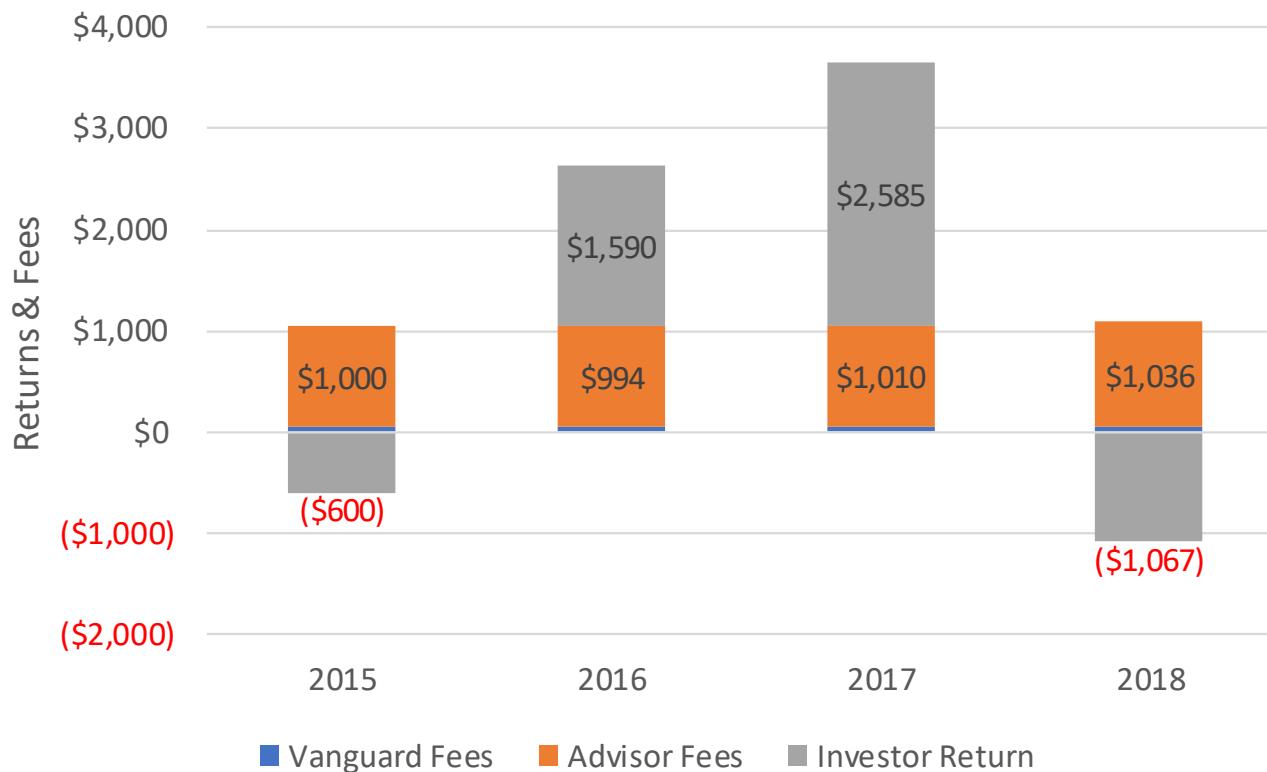
*The status quo works well for Wall Street but **NOT** individual investors*

Investing in large index funds – especially through an advisor – is a bad investment



After investing \$100k over four years in VBTXL, the investor makes \$1,531 less than his advisor

Annual Investor Returns vs. Fees Paid to Advisor and Vanguard*

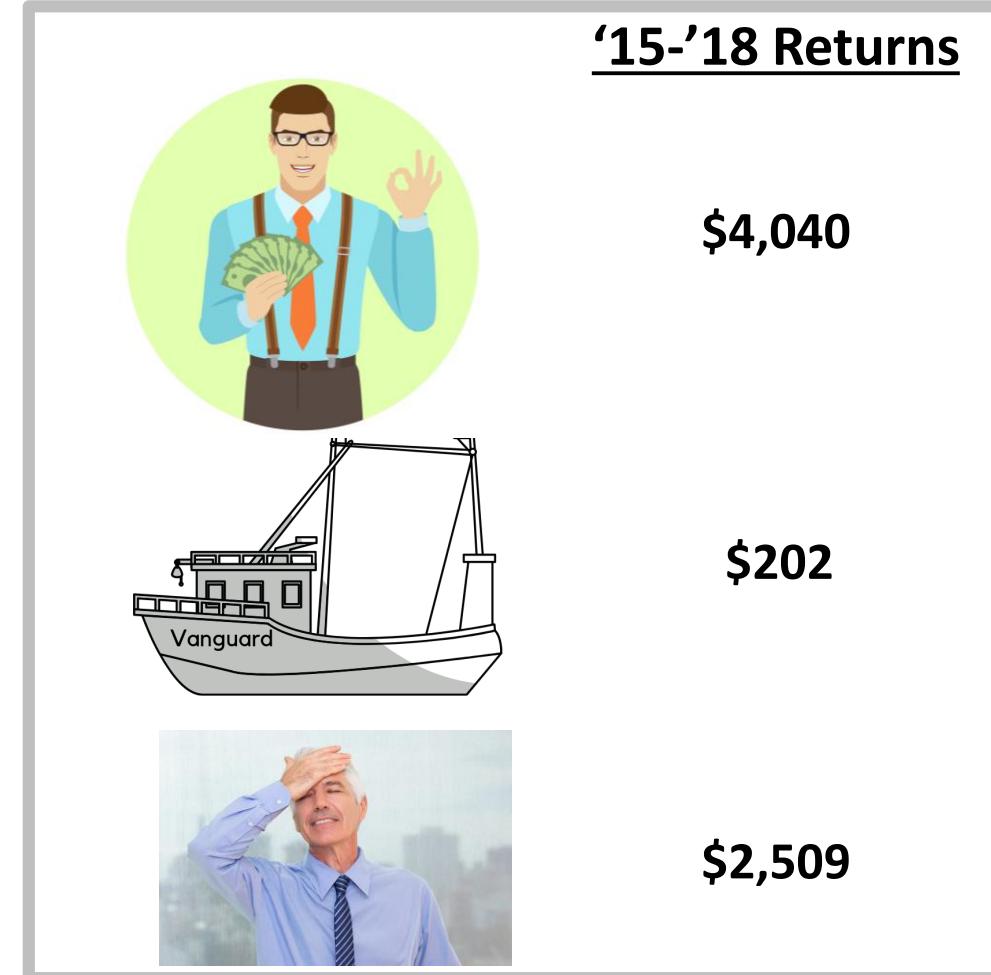


'15-'18 Returns

\$4,040

\$202

\$2,509



* Reflects returns of Vanguard Total Bond Market Index Fund Admiral Shares (VBTXL)

The status quo rewards service providers at the expense of the investor



It's the “Advisor to Vanguard Road to Nowhere”



*Individual corporate bonds
offer strong returns and
lower risk but are less than
1% of US investor assets*

Agenda

- 1. Corporate Bonds 101**
- 2. Why is active corporate bond investing important?**
- 3. How not all bonds fall when Treasury yields rise**
- 4. Why sell bonds prior to maturity?**
- 5. Do the 'Big Guys' really get better prices?**
- 6. How we find bonds that can outperform**

Please ask questions throughout the presentation

Corporate Bonds 101 – Coupon and Maturity

Verizon **3.85%** **11/1/42**

Coupon:

- Paid semi-annually until maturity date
- \$38.50 in interest received annually for each bond owned
 - \$385 per year if owned 10 bonds

Maturity Date:

- Date at which company returns face value (“par”) to investor (\$1,000 per bond)
- Price you pay for a bond could be higher (‘premium’) or lower (‘discount’) than par value

How Bonds Are Quoted & What You Pay

Bid / Offer Quote

85.00 / 85.50

How bonds are quoted:

- Percentage of face value
- Face value of one bond is \$1,000

Sell 1 Bond for:

\$850.00

Buy 1 Bond for:

\$855.00

*Plus Interest Accrued
Since Last Coupon*

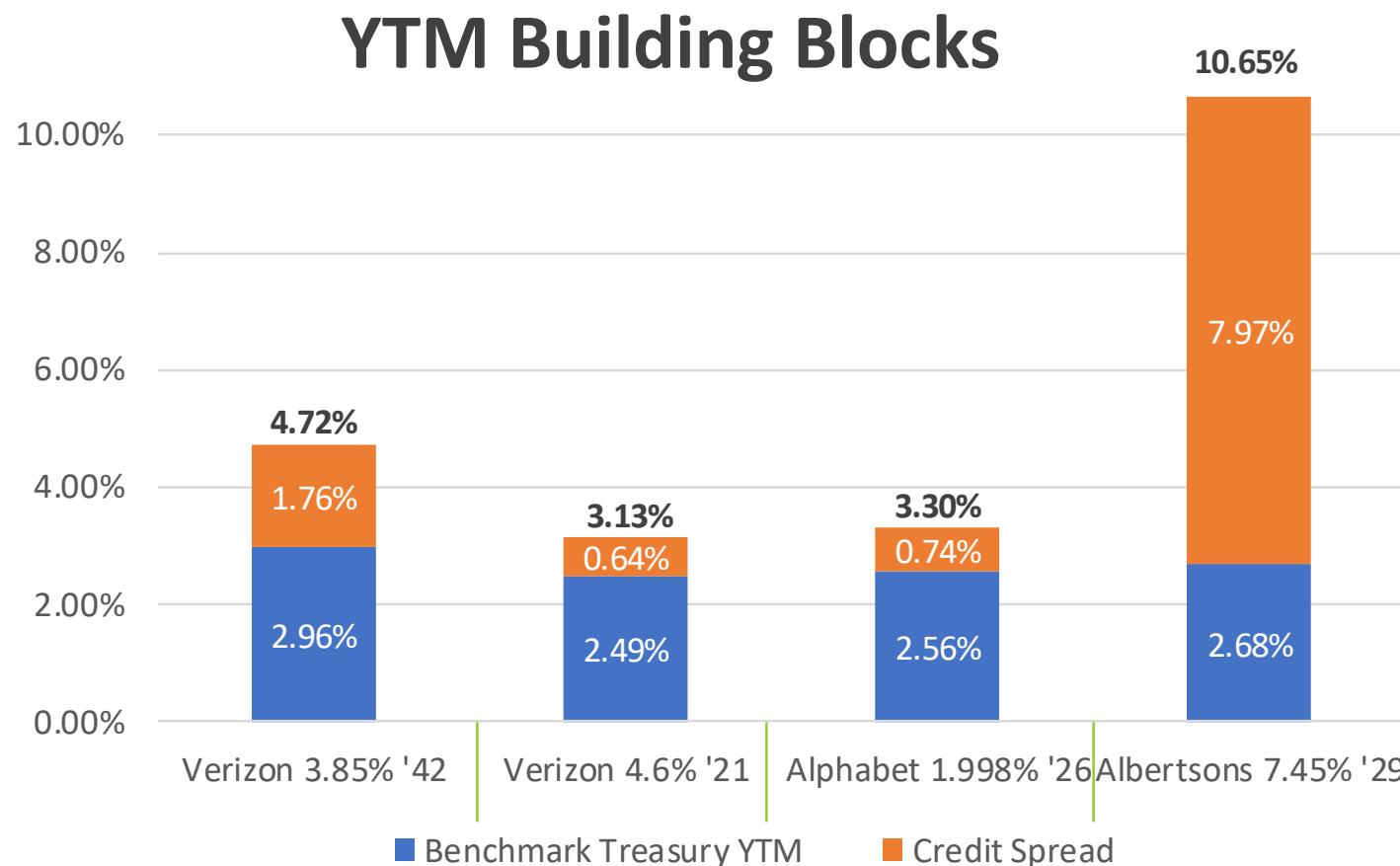
Current Yield vs. Yield to Maturity

Verizon 3.85% 11/1/42

Bid-Offer Quote		Current Yield	Yield to Maturity
87.11 / 87.65	If Bought at Par	3.85%	3.85%
\$876.50 to buy one bond	If Bought at 87.65	4.39%	4.72%

Current Yield at 87.65 = $\$38.50 \div \876.50

How Treasury Yields & Credit Spreads Impact Bond Prices



Benchmark Treasury YTM

+

Credit Spread

=

Corporate Bond's YTM

*So How Should You Invest in
Individual Corporate Bonds?*

Why Is Active Corporate Bond Investing Important?

Active corporate bond investing positions investors to capitalize on market dynamics that can work to their advantage



- Not all bonds are sensitive to interest rates, and investors should adjust accordingly
- Bond prices have ceilings and investors should sell once return is maximized
- Buy as prices fall due to often irrational selling:
 - Follow-the-herd investors selling when bonds are downgraded
 - Forced selling driven by bond fund and ETF redemptions
 - Overreactions to a bad quarterly earnings report



Corporate Bonds Don't Always Move in Lockstep with Treasurys

Investment-grade and high-yield corporate bonds react differently to changes in Treasury yields

Verizon 3.85% 11/1/42 vs. Comparable Treasury

Verizon 3.85% 11/1/42



US Treasury 2.75% 11/15/42



Source: Historical Verizon '42 and US Treasury prices are from FINRA market data.

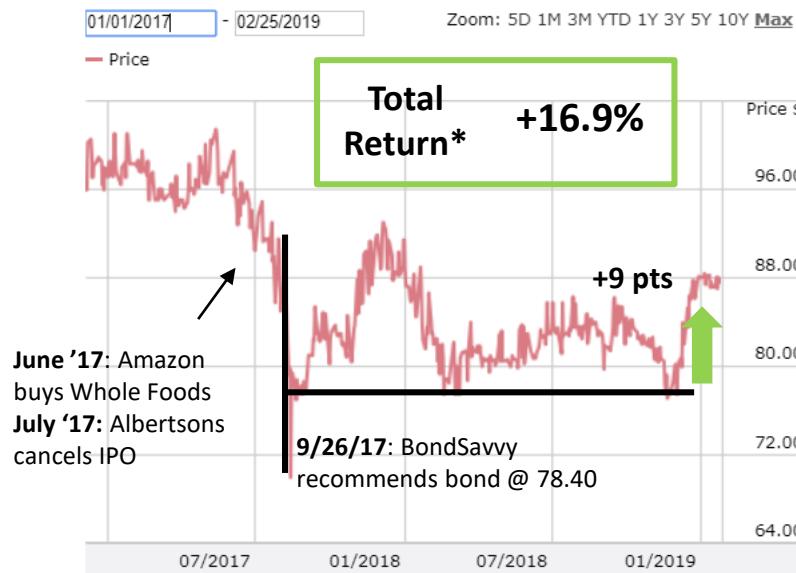
* Verizon return based on top-of-book bid price available on Fidelity on Feb 25, 2019 at 5:00pm EDT and market price on September 26, 2017.

Not All Bonds Go Down When Rates Increase

Even as the comparable Treasury fell 8 points, this Albertsons '29 bond had returned 16.9%*, due to strong performance and reduced concern around the Amazon / Whole Foods merger

Albertsons 7.45% 8/1/29 vs. Comparable Treasury

Albertsons 7.45% 8/1/29



US Treasury 6.125% 8/15/29

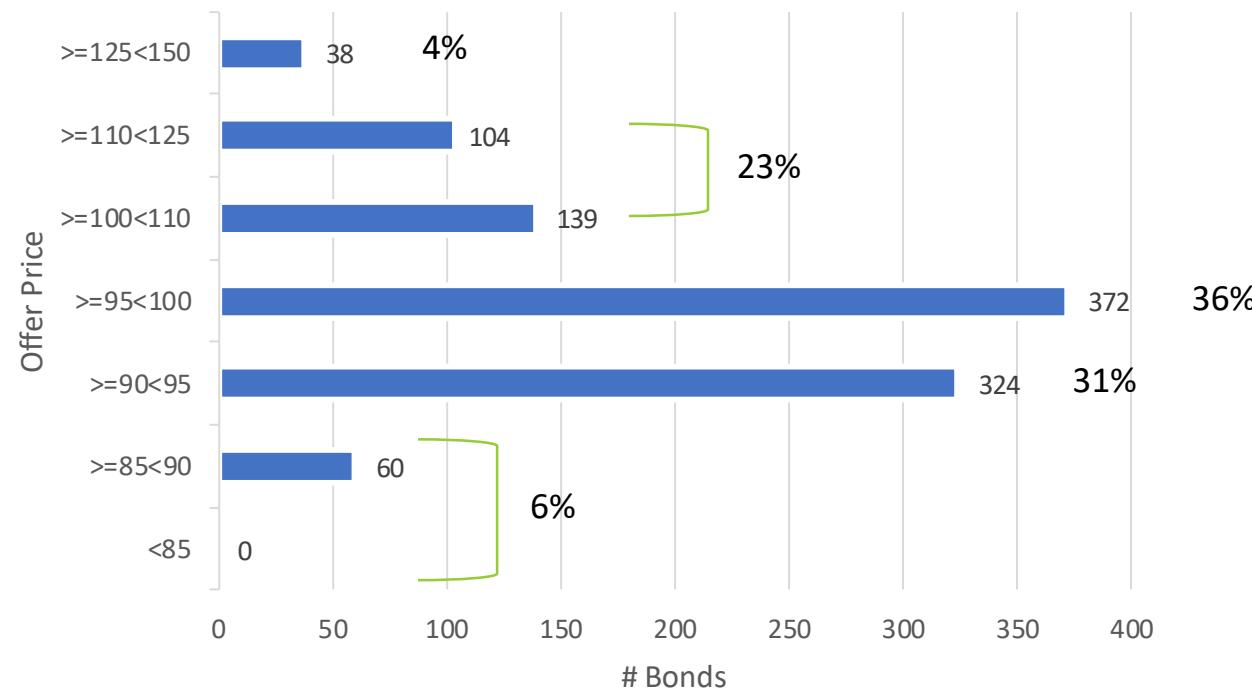


* Returns are from September 26, 2017 through February 25, 2019. Feb 15 price based on top-of-book bid price available on Fidelity at 5:00pm EDT. All other historical prices are from FINRA market data

Corporate Bonds Have Price Ceilings

If a bond goes up materially in price, investors should consider selling the bond to lock in the return

Investment-Grade Bond Offer Prices – 1,037 Bonds YTM 4.25+%*



- Few bonds trade above 125
- Locking in capital appreciation is especially important for lower-coupon bonds that can't 'out-yield' a fall in price
- Bonds trading at a discount generally have greater upside and less downside than premium bonds

How BondSavvy Approaches Credit Ratings

While credit ratings don't speak to the value of a bond, investors must understand ratings momentum given how strongly ratings changes impact bond prices

- Thousands of bonds have the same rating
- Many follow-the-herd investors react to credit rating changes
- Ratings can go unchanged for years
- **SPOILER ALERT:** Rating agencies often get it wrong
- We look to understand ratings momentum

S&P Ratings Distribution*

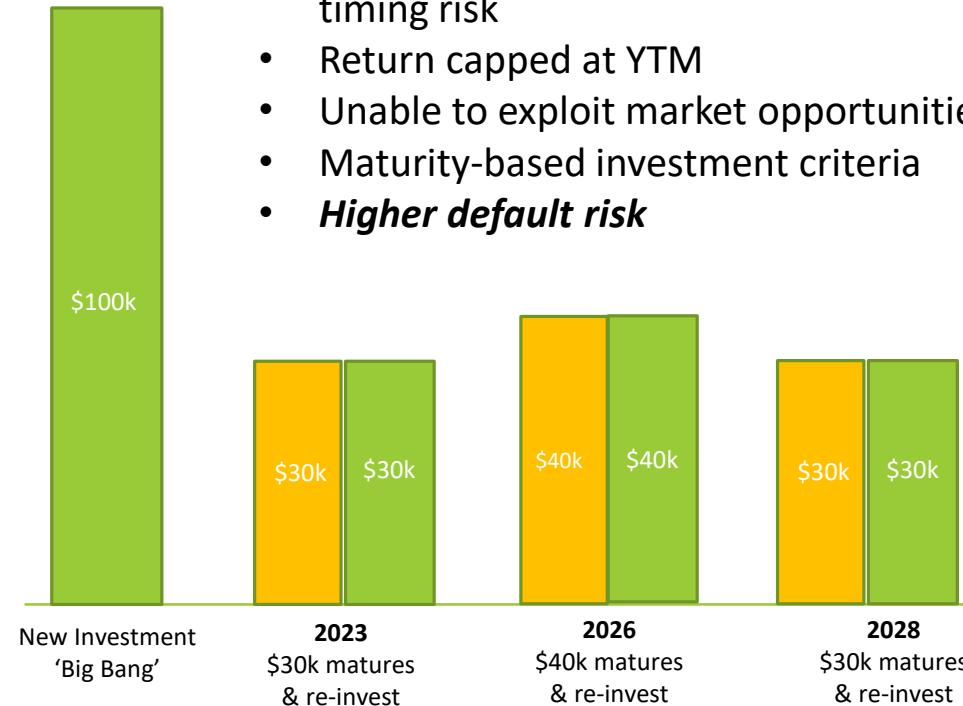
S&P Rating	# Bonds
BBB+	379
BBB	322
BBB-	183

Active Corporate Bond Investing vs. Bond Laddering

Active bond investing has a number of advantages vs. traditional bond ladders

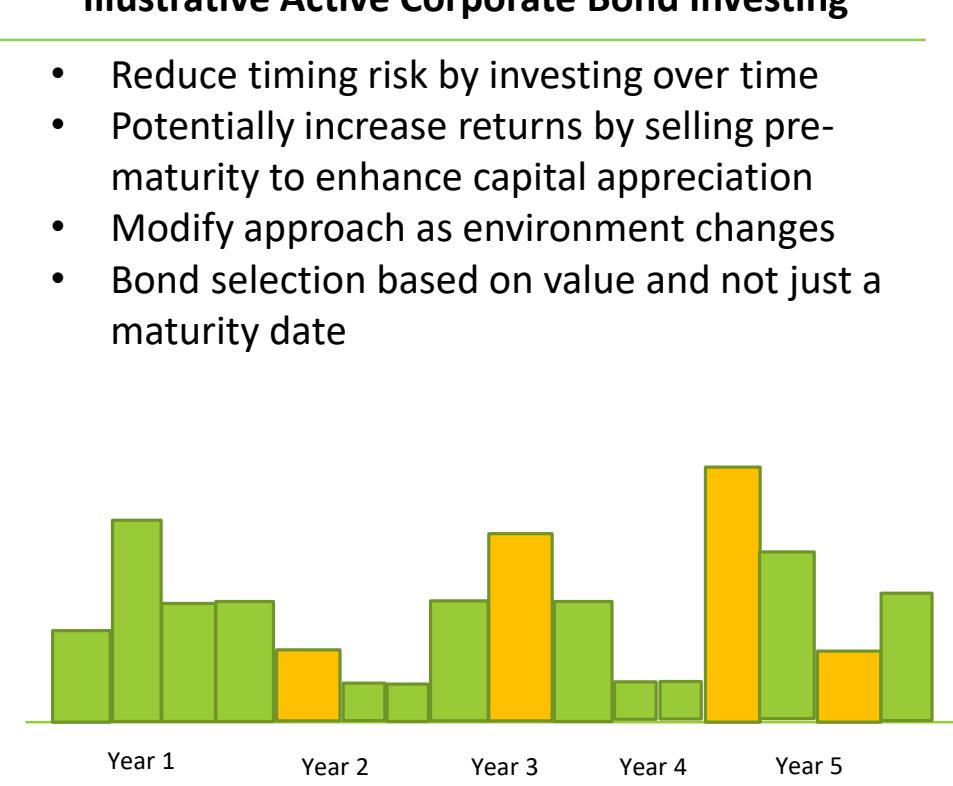
Illustrative \$100k Bond Ladder

- 'Big bang' initial investment with high timing risk
- Return capped at YTM
- Unable to exploit market opportunities
- Maturity-based investment criteria
- ***Higher default risk***

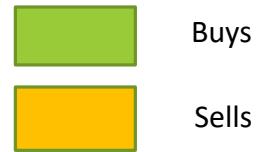


Illustrative Active Corporate Bond Investing

- Reduce timing risk by investing over time
- Potentially increase returns by selling pre-maturity to enhance capital appreciation
- Modify approach as environment changes
- Bond selection based on value and not just a maturity date



Legend:



What Active Corporate Bond Investing Is and Is Not

Active Corporate Bond Investing IS NOT

- Day trading
- Selling as soon as a bond goes up 10 points
- Selling as soon as a bond goes down 10 points
- A slick computerized algorithm



Active Corporate Bond Investing IS

- Generally 2- to 4-year holding period
- Maximize returns over 2- to 4-year periods
- Add to positions over time, including when prices fall
- Careful analysis of each opportunity

Technology Has Put Individual Investors on a More Level Playing Field with Institutional Investors

25 Years Ago



Today



Investing online enables investors to see broad inventory at competitive prices

Liquid Market That Enables Active Investing

Corporate bonds trade in a competitive, two-sided market compared to muni bonds, which typically have only one quote on the offer side and no live bid-side quote

- This Alphabet bond had 8+ dealers quoting and a bid-ask spread of 0.34 points (5 bps)

Alphabet 1.998% '26 – Depth of Book*

BIDS				
Qty	Min Qty	Price	Yield	
200	15	88.650	3.683	
250	10	88.646	3.684	
100	9	88.613	3.689	
99	10	88.483	3.71	
200	2	88.470	3.712	

OFFERS				
Qty	Min Qty	Price	Yield	
383	10	88.991	3.629	
99	10	89.010	3.626	
500	10	89.024	3.624	
14	2	89.052	3.619	
150	15	89.060	3.618	

Competitive Marketplace in High-Yield as Well

The bid-ask spread is slightly wider for the Albertsons '29 bond – 1.20 points – compared to the Alphabet bond, but it's still a competitive market with 6+ dealers quoting

- Certain bonds, especially those with a long time until maturity, can have wider dollar-price spreads
- This can impact holding periods since investors will need to 'overcome' this through yield or capital gain

Albertsons 7.45% '29 – Depth of Book*

BIDS			
Qty	Min Qty	Price	Yield
250	15	85.550	9.63
25	20	85.362	9.661
250	1	85.100	9.706
50	10	85.000	9.722
500	10	84.600	9.79
100	10	83.000	10.066
100	10	79.388	10.715
25	5	77.500	11.074

OFFERS			
Qty	Min Qty	Price	Yield
250	5	86.750	9.431
100	1	87.000	9.39
10	10	87.092	9.375
500	10	87.370	9.329
100	1	88.000	9.227
20	1	99.100	7.571

Minimum quantities are retail-investor friendly

Corporates Better Suited to Active Investing Than Munis

Corporate bonds have a number of attributes that make them better suited to active investing than municipal bonds

	Corporate Bonds	Municipal Bonds
Live, two-sided quotes	✓	—
More trades per CUSIP	✓	—
More frequent financial disclosures	✓	—
Narrower bid-ask spreads	✓	—
Greater variety of credit profiles	✓	—

How Do We Discover Compelling Investments out of 9,000 bonds?

How We Begin Narrowing Down Bonds

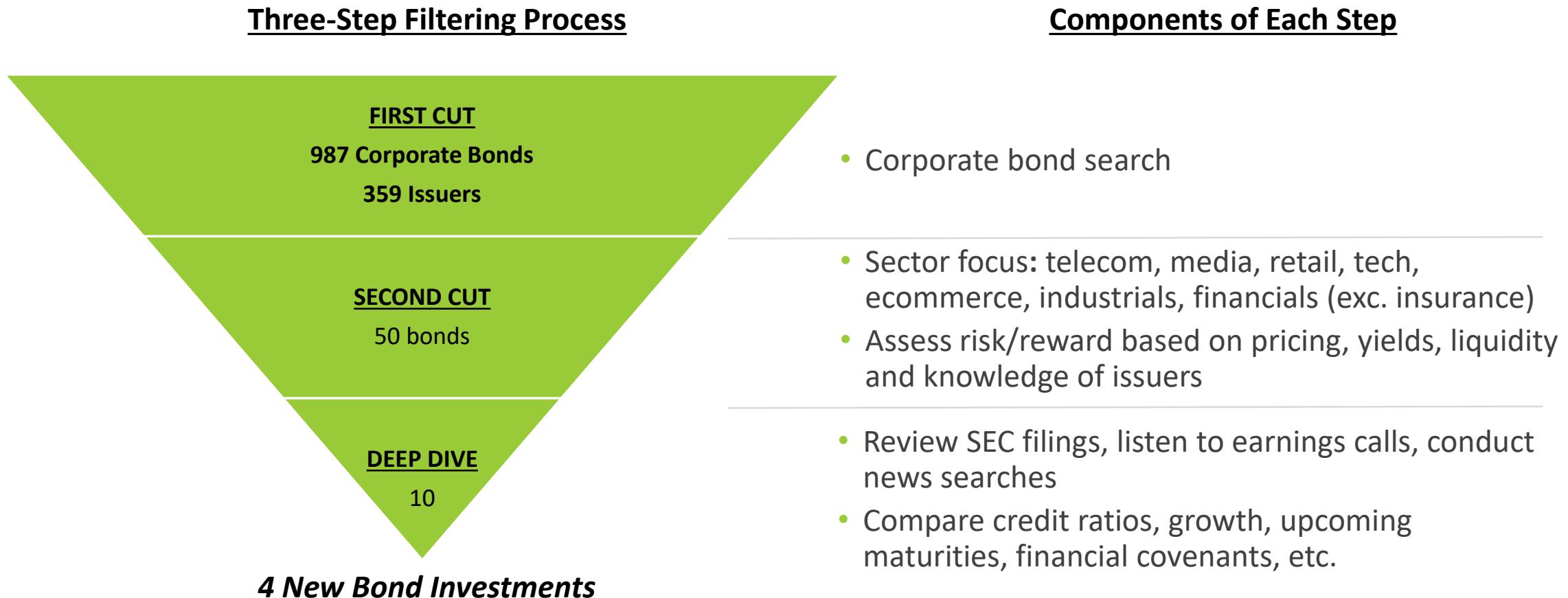
The below search* returned 1,037 unique CUSIPs

SECURITY	
Security Type	Security Type: Corporate Categories: Industrial, Utility, Financial, Telephone, Transportation
Quantity	Min \$ 10,000
Maturity Date	From 5y
Credit Rating	Moody's: Min Baa3 S&P: Min BBB-
Price	Min []
Yield	Min [] %
Yield to Maturity	Min 4.25 %

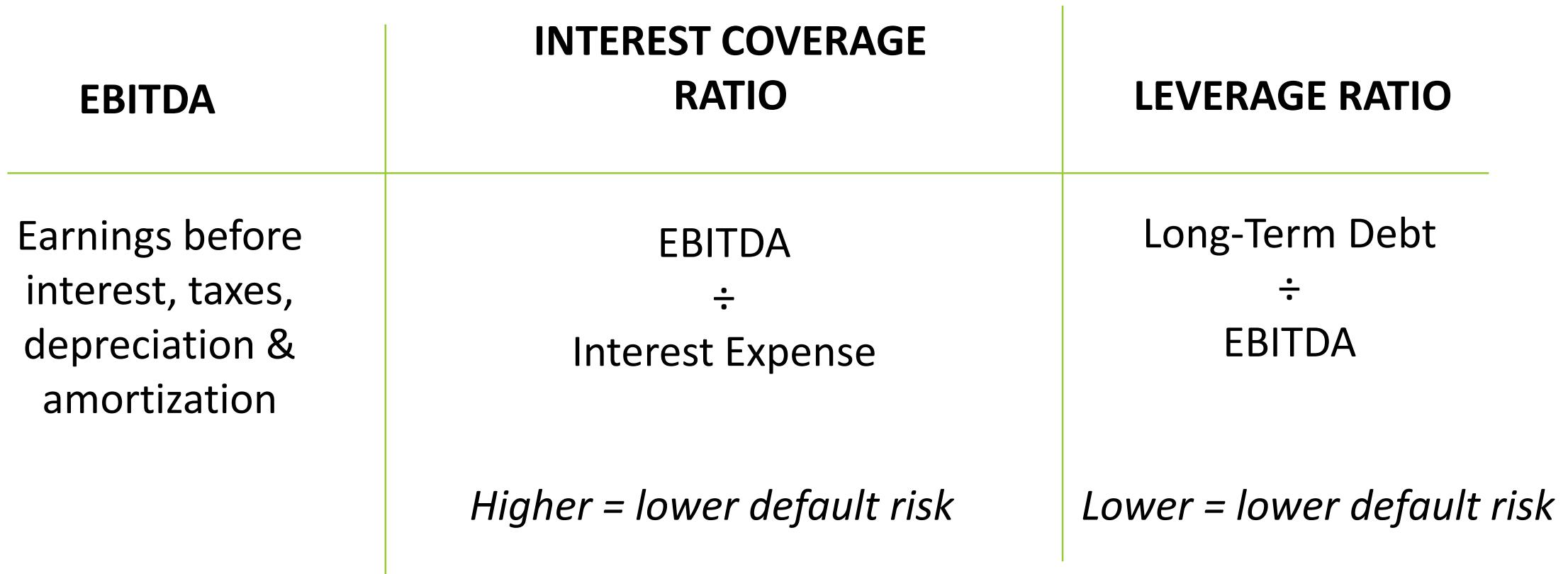
...Luckily, the number of different issuers is smaller and we can further narrow down based on our expertise

Criterion	Unique CUSIPs	# Issuers
YTM 4.25+%, 5-15 maturity	1,037	374
Remove 'out of scope' investments (pharma, oil & gas)	50	15
First Cut	987	359

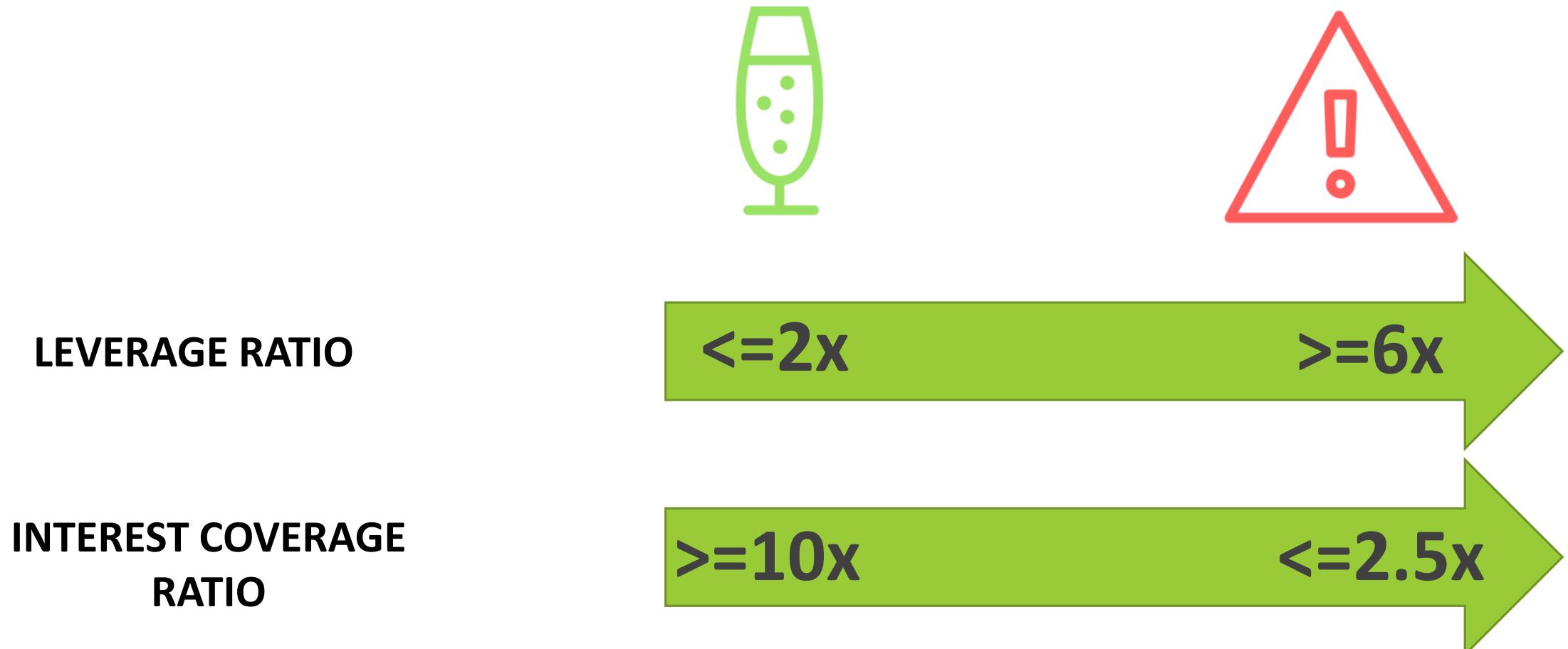
Finalizing Investment Decisions



Key Metrics To Evaluate Bonds



Corporate Bond 'Sweat Meter'



How We Assess Risk and Return

When evaluating the Albertsons '29 and Verizon '42 bonds, we believed both bonds had upside and fairly compensated investors for the risk they were taking

Bond and CUSIP	Ask Price	Yield to Maturity	Spread to Treasury	Leverage Ratio	Interest Coverage Ratio
Albertsons Inc. 7.45% 8/1/29 013104AF1	78.40	10.74%	8.46%	4.3x	3.1x
Verizon 3.850% 11/1/42 92343VBG8	89.62	4.55%	1.82%	2.5x	11.7x

What Else Do We Evaluate?

Apart from comparing credit ratios and credit spreads, we analyze:

- Upcoming debt maturities
- Revenue and EBITDA growth
- Ratings momentum
- Financial covenant headroom
- Liquidity in specific bond
 - Number and size of quotes
 - Trade frequency
- Bond's term premium vs. Treasury curve
- Relative seniority of bond

Key Takeaways

- New opportunities present themselves over time – not all at once
 - New earnings releases
 - Merger & acquisition activity
 - Ratings changes and fund flows can move markets (not always rationally)
- Since bond prices have ceilings, selling prior to maturity can help increase returns
- Active bond investing does not mean ‘day trading’
- Higher-rated bonds may have less default risk but don’t always have less overall risk

Investors can combine the competitive markets of online investing with an active investment approach to achieve strong returns



***NEXT SET OF BOND INVESTMENT
RECOMMENDATIONS:***

March 15 @ 11:00am CT



Thank you

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Q&A