# Money Wise

Colin Bloodworth looks at the various bond options available and explains their associated risks

# Bonding With the Right Investment

Last week we looked at government bonds and their place in investment portfolios. Where US bonds, otherwise known as Treasuries, are concerned, they show little prospect of offering investors real growth prospects in the near future, given their current return of less than 2 percent per annum on a 10-year bond. Worse, if general interest rates rise, the face value of the bond will fall if sold before maturity. Having said that, such bonds play a critical part in preserving capital.

While bank deposits have limited protection, government bonds are guaranteed by the country that issues them. A default is still possible, but if a country has control over its currency then it only has to print money to repay the debt. And as long as the money is there, irrespective of its purchasing power, pension funds and insurance companies can meet their obligations.

But major market government bonds are just a part of the whole bond story. Other types of bonds pay much higher returns but, as with all investments, higher returns imply higher risk. Let's take a look at some of the options.

#### Emerging market bonds

Indonesia falls into the category of an emerging market. Here too the government needs to raise money through bonds as raising money through taxes is unpopular.

If the government offered a return of less than 2 percent per annum in rupiah, in line with the US government's rate in US dollars, there would be few takers as the market perception (which isn't right all the time) is that US bonds are a safer bet. Therefore, Indonesia has to offer a higher rate, currently over 5 percent per annum, in order to sell the bonds.

Other emerging markets do the same. Many foreign investors see the higher rates as an opportunity for profits, particularly in the current climate where some Asian currencies are actually strengthening against the US dollar. The risk for international investors is that if there is global financial turmoil, it is usually emerging nations that take the biggest hit and it doesn't take a large fall in a currency to turn an attractive rate of interest into a loss in hard currency. Another danger is the risk of a complete default. But if markets are calm, the returns on emerging market bonds can be very attractive.

To mitigate fears of currency risk, governments will sometimes issue bonds in hard currencies, usually US dollars. They will offer significantly higher rates than those of US Treasuries, but the big difference is that should things get tough, other countries cannot print US dollars so the risk of default is higher.

#### Corporate bonds

Countries are not the only entities that need to raise cash. Companies can raise cash through the issue of shares or by borrowing from banks. But banks are not so keen to lend money these days and when they do, they often impose draconian conditions. So many companies seek loans in the form of bonds from the public as well as from institutions such as pension funds and insurance companies. They attract funds by offering interest rates that exceed those of banks or government bonds. Of course, they do not come with the same guarantees as bank deposits or government bonds, but if the companies are perceived to be strong and reputable, they will have no difficulty raising funds.

As with governments, corporations can also issue debt in currencies other than that of the home country. A recent example in Indonesia is that of Lippo Karawaci, which has just raised $130 million from selling eight-year US dollar-denominated bonds. The bonds were priced to yield 5.25 percent, a very attractive return compared to US Treasuries, which currently pay under 2 percent for the same term.

The issue was heavily over-subscribed, which would indicate strong market confidence and that the offered yield could have been lower.

#### How to access bonds?

It's very easy via mutual funds. If you are looking for capital protection you should stick to government bonds. If you are comfortable with a modest level of risk, but still below the risks and returns of stock markets, then you should consider a corporate bond or emerging market bond fund. Or again, if you want a mixed basket of assets, look at a managed or balanced fund, which should include a portion of bond funds as well as stocks. As with stocks, and although they are equally liquid, bonds should be seen as part of a long-term investment strategy and not a means of making a quick buck.

Colin Bloodworth, director of PPI Indonesia, has spent more than 20 years in Indonesia. If you have any questions on this or a related subject you can contact the writer at indonesia@ppi-advisory.com