High Yield Bond Fact Sheet

Important Risk Warning

- Bond is an investment product. The investment decision is yours but you should not invest in this product unless the intermediary who sells it to you has explained to you that the product is suitable for you having regard to your financial situation, investment experience and investment objectives
- Bond is NOT equivalent to a time deposit
- Issuer's Risk – The bond is subject to both the actual and perceived measures of credit worthiness of the issuer. There is no assurance of protection against a default by the issuer in respect of the repayment obligations. In the worst case scenario, you might not be able to recover 100% of the principal or receive any coupon if the issuer defaults on the bond
- Additional risks are disclosed in the section of "Risk Disclosure for All Bonds" and "Additional Risk Disclosure for High Yield Bonds" below. Please refer to them for details

What are High Yield Bonds?

- High yield bonds are corporate bonds rated below BBB- or Baa3 by established rating agencies – Moody's Investors Service, Standard & Poor's Ratings Services, etc
- High yield bonds typically offer higher interest rates than government bond or investment grade corporate bonds
- High yield bonds have the potential for capital appreciation in the event of rating upgrade, an economic upturn or improved performance at the issuing company
- Credit rating agencies evaluate issuers and assign ratings based on their opinions of the issuer's ability to pay interest and principal as scheduled. Those issuers with a greater risk not paying interest or principal in a timely manner are rated below investment grade. These issuers must pay a higher interest rate to attract investors to buy their bonds in order to balance the risks associated

		Moody's	Standard&Poor's	Fitch
Investment grade	Strongest	Aaa	AAA	AAA
		Aa	AA	AA
		A	A	A
		Baa	BBB	BBB
Non-investment grade		Ba	BB	BB
		B	B	B
		Caa	CCC	CCC
		Ca	CC	CC
		C	C	C
	Weakest	C	D	D

Table: Credit rating – These credit ratings are reflective of obligations with long-term maturities

HSBC

Who issues High Yield Bonds?

- Emerging or start-up companies that have not yet achieved the operational history, the size or the capital strength required to receive an investment-grade rating
- Companies seeking relatively higher leverage to stimulate growth, who may be rated non-investment grade by credit rating agencies. This may be large or small companies

What are the benefits for investing in High Yield Bonds?

- In summary, high yield bonds play an important role in a portfolio, enhancing return potential while improving diversification, particularly due to their low correlation to investment grade bonds. High yield bonds can be similar to equities in that they tend to be heavily influenced by developments in the issuer, but the income provided by high yield bonds and their senior placement in the capital structure help make high yield bonds attractive investment, given the higher degree of associated risks (please read carefully the sections on “Risk Disclosure for All Bonds” and “Additional Risk Disclosure for High Yield Bonds”)
- **Enhanced regular income** – High yield bonds usually offer higher yields than government bonds and many investment grade corporate bonds. The yields vary depending on the economic climate, generally rising during downturns when default risk also rises
- **Portfolio risk diversification** – High yield bonds are often considered a separate asset class, involving different characteristics from those of other securities. High yield bonds can help investors spread assets across different segments of the financial market, reducing risk concentration in any one asset class in a well-diversified portfolio
- **Potential capital appreciation** – Positive events in the economy, industry or issuing company can potentially reward investors with increases in high yield bond’s price. These events include ratings upgrades, improved earnings reports, mergers or acquisitions, positive product developments or market-related events
- **Relative security over equities investment** – If an issuer is liquidated, bondholders usually have priority over stockholders in an issuer’s capital structure and are more likely to receive payment. Bondholders of high yield bond are entitled to an issuer’s assets ahead of preferred or common stockholders

Why don’t I just stay with investment grade bonds, which have relatively lower risks?

- High yield bonds may offer some advantages over investment grade bonds, depending on the market conditions, but with higher degree of associated risks (please read carefully the sections on “Risk Disclosure for All Bonds” and “Additional Risk Disclosure for High Yield Bonds”). High yield bonds offer:
  - A higher rate of regular interest income;
  - Price volatility provides more trading opportunities if the market liquidity is favorable;
  - Potential for capital appreciation if the debt is upgraded by one of the credit rating agencies, which could be more profound in high yield bonds, especially if a bond is upgraded to investment grade

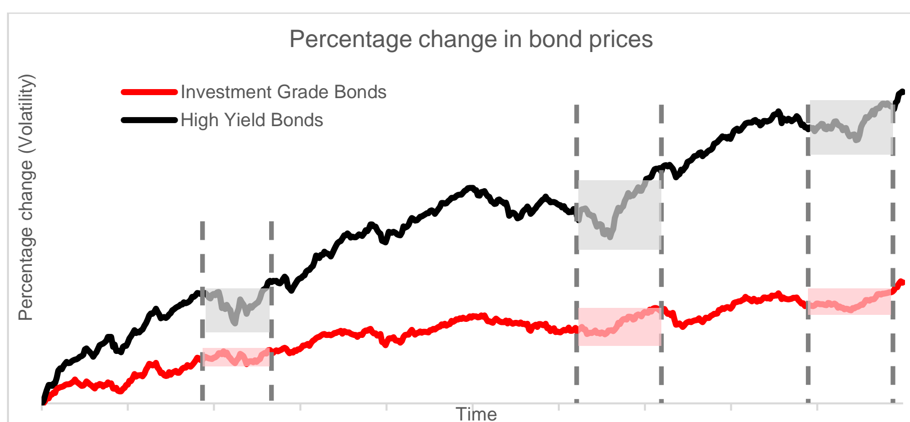

Figure: Price volatility is typically higher for high yield bonds as compared to investment grade bonds

Why is it a good time to invest in High Yield Bonds amid equity market uncertainty?

- Relative to the potential volatility of equities in the short term, bonds in general are evaluated in the medium and long term investment horizon. While equities prices may gyrate, bond yields are in effect 'locked in' when held to maturity as long as there is no issuer default event
- While the volatility of other lower yielding investment may be more manageable, investors may have to give up some return when investing in low yield investment
- Not only will bonds improve risk/returns ratio and diversify portfolio, by employing a buy & hold strategy, you will receive a stable coupon payout and your capital in full at maturity as long as there is no issuer default event. For equities, the payout ratio is relatively unstable due to fluctuating equity prices
- Investors should be aware of the risks associated with any investment products in any market environment
- Under uncertain market condition, investors should consider whether high yield bonds are suitable for them in light of their financial circumstances, investment objectives, and risk profiles

How do High Yield Bond investors manage risks?

- High Yield Bond investment comes with certain risks, there are techniques practiced by investors to manage risks
- **Diversify across issuers and industry segments** – Investors should not put all their assets in one high yield bond. Spreading investment among several issuers and industries can help reduce the risk of price declines or defaults caused by industry-specific events
- **Adjust portfolios over economic and market cycles** – One of the best times to own high yield bonds is during the expansion phase of an economic cycle, when financial measures are increasing along with consumer confidence
- **Monitor rating agencies** – Follow the publications of the rating agencies, which may indicate advance warnings of market difficulties. Prior to downgrading the rating of an issuer, agencies often place the company on a "creditwatch" list
- **Monitor company and industry news** – Investors should follow an industry or an issuer closely – just as investors would follow equities – to help anticipate factors that may impact the credit rating or the price of a bond

Risks disclosure for all bonds

- Bonds are mainly for medium to long term investment, not for short term speculation. You should be prepared to invest your funds in bonds for the full investment tenor; you could lose part or all of your investment if you choose to sell your bonds prior to maturity
- It is the issuer to pay interest and repay principal of bonds. If the issuer defaults, the holder of bonds may not be able to receive back the interest and principal. The holder of bonds bears the credit risk of the issuer and has no recourse to HSBC unless HSBC is the issuer itself
- Indicative bond prices are available and bond prices do fluctuate when market changes. Factors affecting market price of bonds include, and are not limited to, fluctuations in interest rates, credit spreads, and liquidity premiums. The fluctuation in yield generally has a greater effect on prices of longer tenor bonds. There is an inherent risk that losses may be incurred rather than profit made as a result of buying and selling bonds
- If you wish to sell the bonds purchased through HSBC, HSBC may repurchase them based on the prevailing market price under normal market circumstances, but the buying price may differ from the original selling price due to changes in market conditions
- There may be exchange rate risks if you choose to convert payments made on the bonds to your home currency
- The secondary market for bonds may not provide significant liquidity or may trade at prices based on the prevailing market conditions and may not be in line with the expectations of the bond holders
- If a bond is early redeemed, you may not be able to enjoy the same rates of return when you re-invest the funds in other investments

Additional risk disclosure for High Yield Bonds

- In general, **high yield bonds are corporate bonds rated below BBB- or Baa3 by established rating agencies – Moody's Investors Service, Standard & Poor's Ratings Services, etc or equivalent credit quality but unrated**. While high yield bonds bear a higher yield opportunity than investment grade bonds, **they present greater risks with respect to liquidity, volatility and non-payment of principal and interest. They incur greater degree of credit risk relative to many other fixed income securities**
- **Default Risk** – Defaults occur when a company fails to pay an interest or principal payment to a debt holder as scheduled and as specified in the legal agreements. The risk of default on principal or interest, or both, is greater for high yield bonds than for investment-grade bonds due to higher credit risk of the high yield bond issuer and lower priority of claim by the high yield bond holders. Many high yield issues are cross border issues (eg Chinese property developers) which have no recovery history for offshore investors reclaiming rights domestically. Therefore, in case of default, the time required for claim on corporate assets in a liquidation distribution may be longer than the investment graded bonds due to lower priority of claim and the domestic restrictions on the high yield bond holders' claim rights
- **Downgrade risk** – Downgrades result when rating agencies lower their rating on a bond; for example, a change by Standard & Poor's from a BB to a B rating. Downgrades are usually accompanied by bond price declines. In some cases, the market anticipates downgrades by bidding down prices prior to the actual rating agency announcement. Before bonds are downgraded, agencies often place them on a "creditwatch" status, which also tends to cause price declines
- **Liquidity risk** – Liquidity refers to the investor's ability to sell a bond quickly and at an efficient price, as reflected in the bid-ask spread. A difference may exist between the prices buyers are bidding and the prices sellers are asking. For largely and actively traded bond, the gap is often smaller, producing greater liquidity. However, the gap is larger for less actively traded bonds which results in a lower liquidity. High yield bonds can sometimes be less liquid than investment-grade bonds, depending on the issuer and the market conditions at any given time. If the bonds are unlisted, secondary market trading is likely to be further restricted than if they were listed
- **Economic risk** – Economic risk describes the vulnerability of a bond to downturns in the economy. Virtually all types of high yield bonds are vulnerable to economic risk. In recessions, high yield bonds typically lose more principal value than investment-grade bonds

- **Volatility risk** – Market value of unrated or non-investment grade bonds tend to be more sensitive to developments involving the issuer and to changes in economic conditions, and thus have greater price volatility than investment graded bonds
- **Company and industry "event" risk** – A variety of pitfalls can affect a company's ability to repay its debt obligations on time. These include poor management, changes in management, failure to anticipate shifts in the company's markets, rising costs of raw materials, regulations and new competition. Events that adversely affect a whole industry can have a blanket effect on the bonds of its members
- **Concentration risk** – Please be aware the concentration risk of investing in bonds issued by the same issuer or companies by the same group. A degrading of any of the group company's credit rating may expose the whole group to contagion risk. Please be also aware the risk of over concentrating investment in the high risk investment products
- **There are investment risks involved in buying High Yield Bonds. Before applying for any of the High Yield Bonds, you should consider whether the High Yield Bonds are suitable for you in light of your own financial circumstances and investment objectives**

Remarks:

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