CORPORATE BONDS

Transforming the market

EDUCATION

From misunderstood to mainstream

Corporate bonds, historically seen as complex financial instruments for large institutions, are about to have their moment. So what will it take for these securities to become more commonplace among retail investors?

Fiona Bond

Corporate bonds have, until now, largely flown under the radar of retail investors. With limited online trading and purchase sizes typically exceeding £100,000 a unit, they have historically been the preserve of large institutions and fund managers.

However, in an environment of low interest rates and unappealingly low returns on cash, there is a growing appetite among retail investors for an alternative to traditional savings products and often-volatile equity markets.

Yet, for many, the question remains: what exactly is a corporate bond? Simply put, corporate bonds are debt issued by companies looking to raise money to fund or expand the business. The company sells the bond to investors in exchange for a fixed rate of interest, known as the coupon rate, and the promise to repay the original investment at a fixed date in the future, known as maturity.

Raising capital through private investors has proved popular among companies that can otherwise face steep interest rates and various lending conditions attached to bank loans. According to the McKinsey Global Institute, almost 20 per cent of total global corporate debt is now in the form of bonds, nearly double that of 2007.

But, despite global growth and efforts in the UK to set up a dedicated retail bond market, most notably the London ORB (Order book for Retail Bonds), corporate bonds have retained an air of mystery among private investors, in part due to the traditionally institutional nature of the market.

Jeremy Spain, fixed income analyst at Charles Stanley, explains: "Either rightly or wrongly, some bonds tend to be looked at as being complex instruments and as such open to the possibility of a greater chance of mis-selling. This illusion has been given greater credence by the publicity surrounding the selling of certain types of fixed income instruments to private investors."

> **"Bonds provide investors with greater certainty over when they will receive their money than equities**

Alix Stewart, fund manager at Schroders, echoes the sentiment that the dynamics of the bond market remain misunderstood. "There seems to be a misconception that without a default on an individual bond you can't lose your principal; however, you can see the value of your fund fall if yields rise and the bond market sells off," she says.

"This has meant that at times when there were big swings in bonds prices and defaults, or fear of defaults on many bonds, it was a shock to see the value of investments move so much."

While private investors have been afforded exposure to company debt through the peer-to-peer market, this form of investing has often been plagued by negative headlines, limited liquidity and concerns over its durability.

In contrast, corporate bond issuances are assigned a rating based on their creditworthiness and offer an attractive investment opportunity that sits between cash and equities on the risk-return spectrum.

Rezaah Ahmad, founder and chief executive of digital bond platform WiseAlpha, says: "Corporate bonds are the best mainstream, risk-adjusted asset class; it is simply that they have been monopolised by institutional investors, leaving them closed off to the everyday investor."

In a bid to liberalise the market, WiseAlpha has fractionalised the bonds of large companies into small units, allowing retail investors to invest in bond issuances from as little as £100.

Mr Ahmad explains: "Many of the companies issuing bonds are the same FTSE 350-listed household names that investors turn to for stock investments. Investors can benefit from transparent corporate reporting and the ability to easily track a company's progress, while experiencing less volatility than equities.

"Bonds also have to be repaid by maturity, providing investors with greater certainty over when they will receive their money in comparison to equities, whose valuations are open-ended. From this perspective, bonds offer less risk and more reward."

Mr Spain agrees that regular interest payments are an alluring prospect if the company is deemed creditworthy.

"The attraction of a fixed rate bond is that it offers a steady stream of income in the form of coupons," he says. "Many investors are happy to take the income produced by a bond and ignore the day-to-day volatility in price, as long as the issuer demonstrates decent debt sustainability."

Broadly speaking, corporate bonds are divided into two risk categories: investment grade, considered low default risk and paying a lower yield; and high yield, otherwise known as junk bonds, deemed altogether riskier, but offering higher returns as way of compensation.

But there are a number of key considerations investors must make when assessing bonds, specifically the financial strength of the issuer, duration of the bond, interest rates and wider economic backdrop.

As Mr Spain explains: "There are plenty of considerations for any potential investor in the fixed-income markets; the most obvious are the prospects for global growth and the length of the current business cycle. These concerns are closely tied into the inflation outlook and any geopolitical risks."

Corporate bonds often offer higher yields than other fixed-income instruments, including government bonds, to offset the higher risk involved. If a corporate issuer runs into financial difficulties, they may default on their interest payments.

In the worst-case scenario, the bondholder could lose all their original investment and, crucially, corporate bonds are not covered by the Financial Services Compensation Scheme. However, if a company defaults, bondholders are higher up the pecking order than shareholders when the proceeds of asset sales are shared.

There is also the cardinal rule of bonds: if interest rates go up, bond prices are likely to go down. But as the saying goes, "He who dares wins". According to WiseAlpha, both investment-grade bonds and high-yield bonds have outperformed UK equities over the last 20 years both in terms of returns and price volatility.

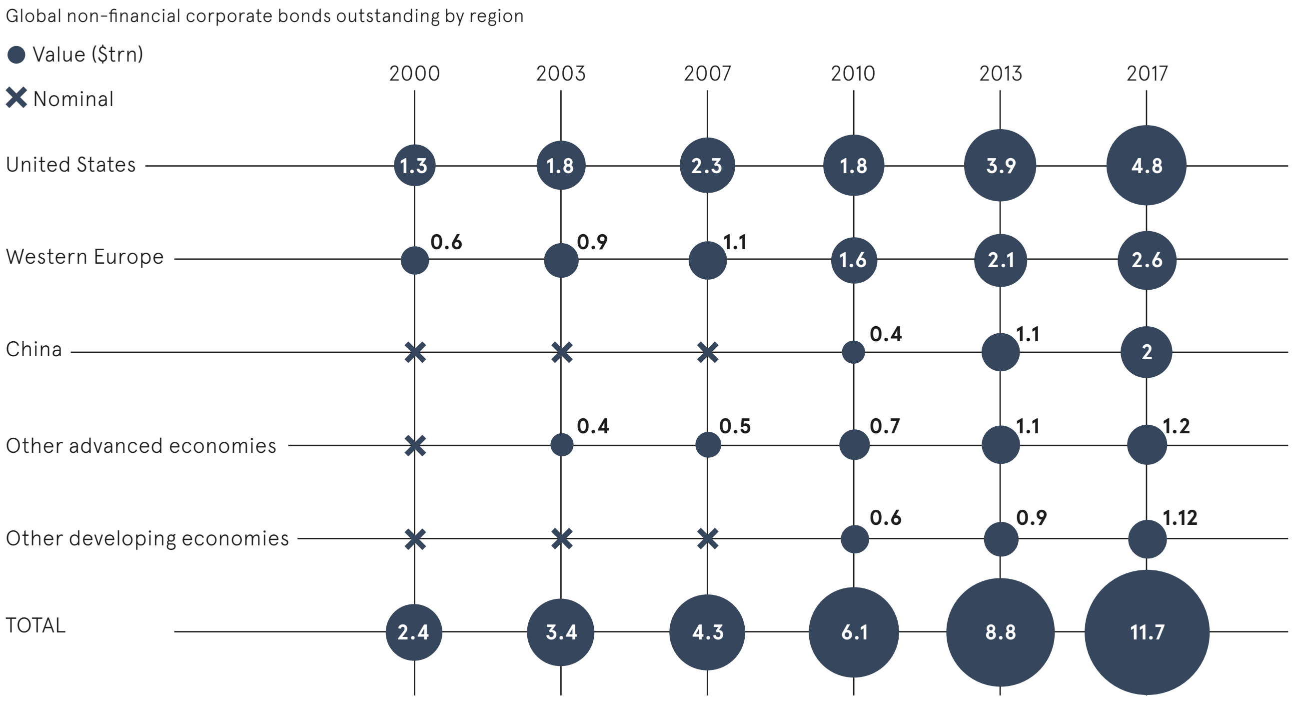
Ms Stewart at Schroders says: "Investors in corporate bonds should look at them as a diversifier from the other parts of their portfolio; they would do well as an alternative to growth or value equities.

"Longer duration funds can provide a good offset to portfolios that would be exposed to a recession as central banks have proven they would cut interest rates further and buy corporate bonds again if the need arose. This would keep corporate bond valuations well supported."

Against a backdrop of economic and political uncertainty, and a concerted push to provide investors with greater access and opportunities, corporate bonds could well become the investment of choice going forward. ●

CHARTING THE RISE OF CORPORATE BONDS

Global non-financial corporate bonds outstanding by region



Dealogic/McKinsey 2018

1/5
of total global corporate debt is now in the form of bonds, nearly double that of 2007

2.5x
increase in corporate bond issuance over the past decade

$11.7trn
global value of corporate bonds outstanding from non-financial companies

McKinsey 2018

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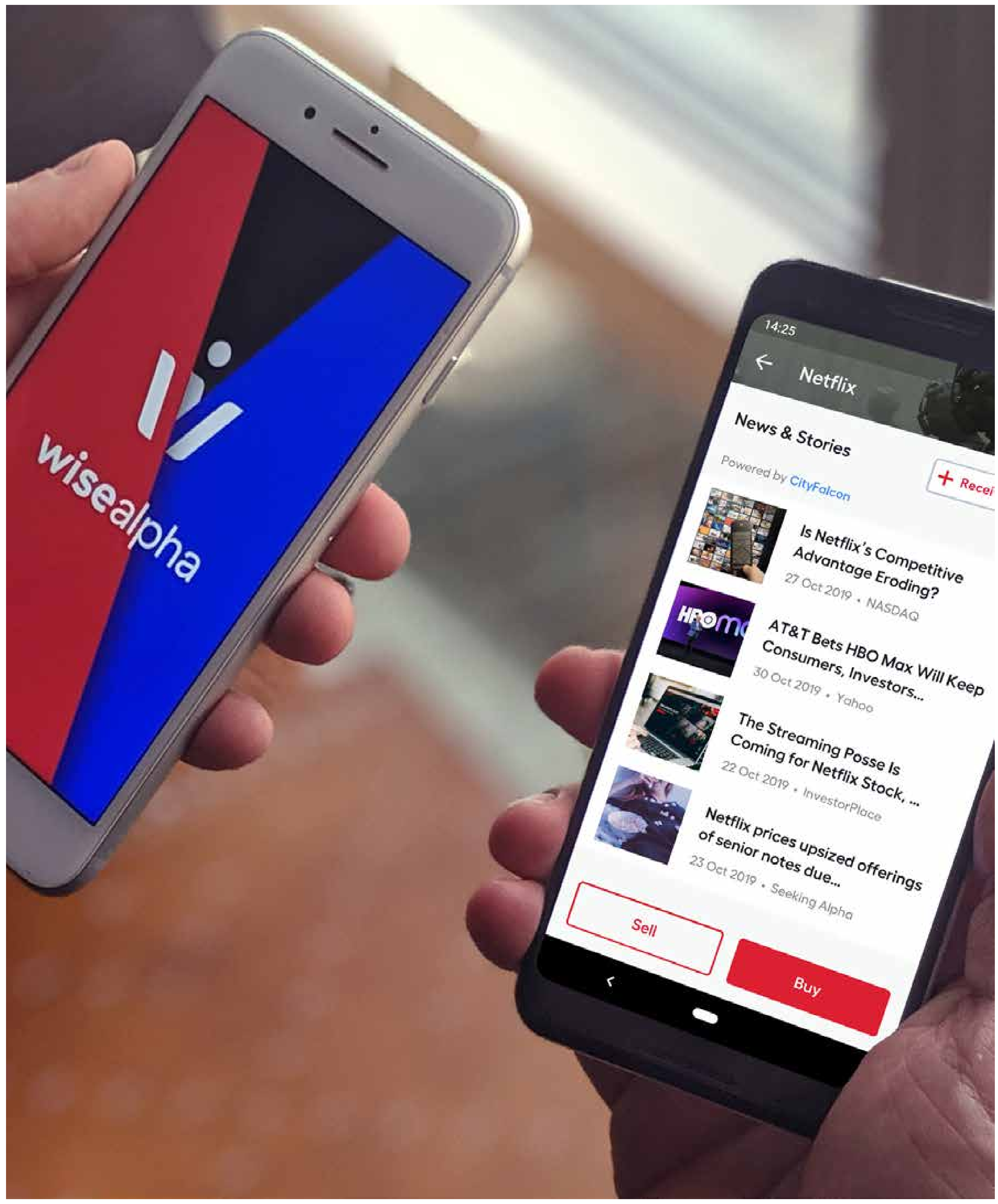
The final frontier: a corporate bond market open to everyone

The corporate bond market is the only major asset class that has been shut off from everyday investors, and dominated by institutions and the super-wealthy. Minimum purchase sizes of £100,000 or more and a pay-to-play institutional bias are at the root of the problem. However, one fintech is leading the digitalisation of the market, enabling everyone to access the superior returns on offer from this exclusive asset class.



The last major financial marketplace to be transformed by technology is the corporate bond market, but a new online trading venue is now providing access to fixed income in affordable sizes.

This sudden liberalisation of the main corporate bond markets amounts to something of a revolution. While in the UK, 53 per cent of pension investments go into bonds[1], direct investment by individual investors in corporate bonds remains negligible. The European Commission recently called for the market to be enhanced[2] and, with equity trading becoming more volatile, access to corporate bonds gives investors a means to buy in to those companies with greater security and reliable returns.

WiseAlpha, the UK's leading digital bond market, has created a new bond-trading venue to cater for mass engagement. "Corporate bonds have traditionally been traded over the counter, by brokers on the phone, and with incredibly high minimum purchase sizes, meaning only institutional or seriously wealthy investors can play in the market. We are changing that completely," says Rezaah Ahmad, founder and chief executive of the company.

The platform offers investors the chance to buy fractions of FTSE 250 size corporate bonds, for as little as £100. Ever since the bond market's inception around 350 years ago, it has largely been closed off from individual investors, so WiseAlpha's radical opening of access is being likened to the digital disruption in the travel industry and the high street.

"It's crazy that private investors have been shut out from this market and even institutional trading has remained so old fashioned," says Mr Ahmad. "WiseAlpha's digital bond market has transformed access to this multi-trillion asset class, allowing investors of all sizes to tap into the stellar returns on offer. The democratisation of the bond market is in motion and it's time for everyone to get on board."

Underlying the new digital market is innovative technology that chops up large bond blocks into affordable, bite-sized pieces. "We're scaling by fractionalising bonds and offering them to thousands of investors who buy and sell on the platform," Mr Ahmad explains.

To use WiseAlpha's bond market, investors simply sign up and choose from the many corporate bonds available. The range of options is large, with many of the biggest names in UK and European business listed on the platform. At any one time, the top-performing household name companies are available to invest in, from Ocado to Virgin Media and Burger King to Vodafone.

The platform's development is well timed given the sustained growth in non-financial corporate bond issuance over the past decade and the simultaneous decline in equity listings. According to the Organisation for Economic Co-operation and Development, outstanding debt in the form of corporate bonds almost doubled in real terms between 2008 and 2018[3]. Even for long-established listed companies, debt issuance in the form of bonds has become highly popular because of the quick access to money at fixed rates and terms.

Prior to the inception of WiseAlpha, several attempts had been made to establish retail bond markets. In the UK, the most notable of these was the London Stock Exchange's creation of the Orderbook for Retail Bonds (ORB) in 2010. But that bond market has seen low issuance in recent years and many long-established companies have not used it for listings.

Investors using WiseAlpha can tap into the broad diversification and strong returns available from the wider corporate bond market. According to Barclays, over the last 20 years, sterling investment-grade corporate bonds returned 6.1 per cent[4], compared with the 5.1 per cent available on FTSE 100 shares[5]. Sterling high-yield fixed income has generated 10.4 per cent[6].

"Investors are wise to consider a more diverse portfolio to reduce their risk and with a much bigger weighting to fixed income. Corporate bonds are the perfect addition to a portfolio and their returns are consistently higher than stocks and shares over the medium term," says Mr Ahmad.

For those new to investing or to corporate bonds, WiseAlpha also offers a robo-management solution called Robowise that allows users to manage their portfolios automatically, while still being able to tailor portfolio settings and take back control if they wish.

Crucially, reselling bonds to other users on the WiseAlpha marketplace is quick[7]. "We're filling the access and liquidity gap, and it will become evermore liquid as thousands of investors continue to join," says Mr Ahmad.

The market's straightforward functionality is also proving attractive to stock-trading platforms and asset managers. "We are now implementing a wide range of partnerships with funds, banks, wealth managers, brokers and money apps to allow them to connect into our bond market so they can offer bonds to their customers," adds Mr Ahmad. "We're building a truly open bond ecosystem, bringing together retail and institutional fixed-income investors, and we're hugely excited about continuing to grow the platform."

Individual investors of all backgrounds are looking for better returns, to diversify their assets and mitigate risks in a constantly changing environment. Thanks to new technology, they can now access the reliable returns of the bond market much more easily than ever before. It is a clear opportunity that private investors are taking up in large numbers.

RETURNS BETWEEN 2000 AND 2019

10.4% sterling high-yield corporate bonds[6]

6.1% sterling investment-grade corporate bonds[4]

5.1% FTSE 100 index[5]

> **The democratisation of the bond market is in motion and it's time for everyone to get on board**

Q&A

Digital bond marketplace

Rezaah Ahmad, founder and chief executive of WiseAlpha, explains the creation of the digital bond marketplace

Q Why did you create WiseAlpha?

A While working in the banking industry, I was struck by how closed and elite the corporate bond market was. Clearly, a full-scale liberalisation of this market was necessary. It's crazy that you can invest easily in the equity of a large company, such as Ocado, but can't easily buy its bonds.

Q What's next for the platform?

A We are the UK's only digital bond market and we want to expand into a platform that is scalable globally. People are on the hunt for better yield and reliable interest income, so providing access to the corporate bond market is essential. Not everyone wants to go on a wild stock market ride and many want greater portfolio diversification.

Q Corporate bonds are being called the must-have investment product for 2020. Why?

A Recent years have seen a rise in prominence of "exciting" alternative assets that have become problematic. I'm thinking particularly of cryptocurrencies, which have been heavily exposed to fraud and volatility. By contrast, bonds are a major, established asset class that has delivered superior risk-adjusted returns. Corporate bonds issued by recognised corporations have been unavailable to most of us, while smaller businesses' bonds and peer-to-peer (P2P) loans have become plentiful. It's like going into a shop and only finding cheap cola instead of Coke or discount chocolate instead of Cadbury. With WiseAlpha, the quality and well-known option is available for the everyday investor.

Q Why is P2P lending so problematic?

A Peer-to-peer lending promised returns above savings account rates and this won it a fair few investors before the regulators started to clamp down. While it may be a potentially interesting option for investors who are aware of the risks, rising loan defaults, declining returns and platform failures have shaken people.

Q Do you think bond trading will become as big as the stock market for individual investors?

A We expect bond trading to become bigger than stock trading. People generally make money more consistently with bonds. Once the right levels of awareness are in place, alongside surrounding market infrastructure, then people will be exposed to the benefits. I also think that a strategic shift is coming in the UK stock-trading market. Those stock platforms that partner with WiseAlpha will likely grow market share significantly.

> **It's crazy that you can invest easily in Ocado equity but can't easily buy its bonds**

Q Why has it been so difficult for consumers to invest in corporate bonds and why should they start now?

A Until very recently, corporate bonds had typically only been sold to institutional investors or very wealthy individuals at a minimum price of £100,000, which is obviously prohibitive. A cosy relationship circle of the biggest banks and asset managers dominates the market, with investors being forced to invest in funds to get fixed-income exposure. With WiseAlpha, people now have the option to purchase fractions of bonds for as little as £100.

Q What happened to the London ORB market for corporate bonds?

A The Orderbook for Retail Bonds market hasn't taken off as one might have liked, after its establishment in 2010. Very few companies now have their bonds listed there and it's not nearly as easy to use or access as WiseAlpha.

Q How can investors use your platform and can you show them which bonds to buy?

A It's easy to use WiseAlpha. You simply log on and start scrolling through the dozens of companies whose bonds you can invest in. All the tools are there to help you find the right investments within minutes. For those uncertain of picking their own bonds, we have a robo-management tool that enables users to create diversified portfolios that rebalance themselves.

Q What sort of returns can investors expect and how easily can people diversify their portfolio?

A The bond market has a rich range of risk and return. Corporate bonds can offer interest coupons from 2 per cent for highly rated companies all the way up to 15 per cent for higher risk. Our robo-portfolios currently return between approximately 6 and 8 per cent on a yield-to-maturity basis. Investors can choose how to balance their portfolios based on simple options. Plus, they can frequently reassess their choices. ●

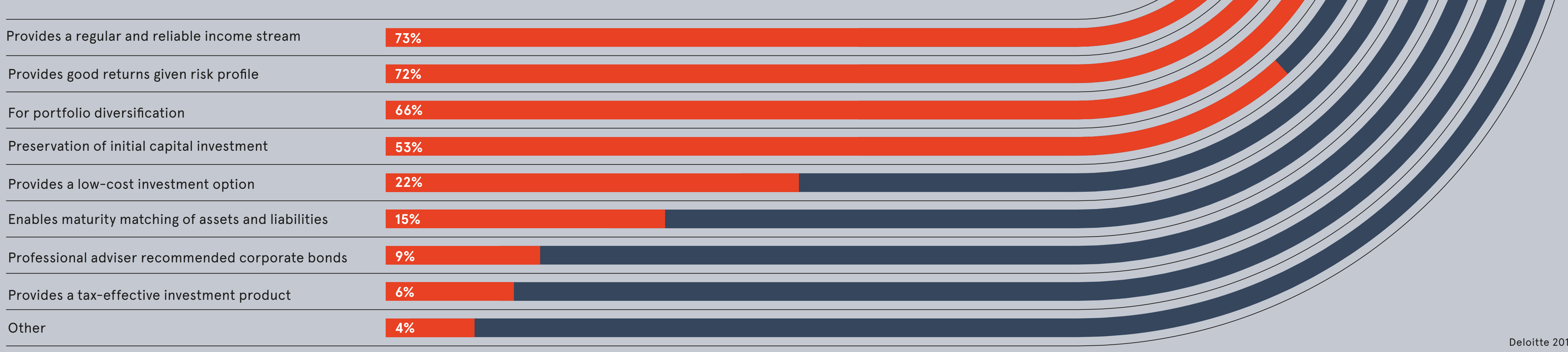
[1] Willis Towers Watson,Willis Towers Watson Global Pension Asset Study 2019 (split between government bonds and corporate bonds not given)
[2] European Commission, *Analysis of European Corporate Bond Markets*
[3] OECD, *Corporate Bonds in a Time of Unconventional Monetary Policy*
[4] Barclays Sterling Investment Grade Index LC61TRGU Sept 2000 to Sept 2019
[5] FTSE 100 Total Return Index TUKXG Sept 2000 to Sept 2019
[6] Bank of America Merrill Lynch Sterling High-Yield Index HL00 Sept 2000 to Sept 2019
[7] Liquidity is not guaranteed.

RISK VERSUS RETURN

Corporate bonds are often overlooked by retail investors, seen as overly complicated financial instruments used exclusively by large institutions and fund managers. But in an environment of low interest rates and volatility in other markets, the risk-return balance has tipped in their favour. This infographic explores why high-net-worth individuals invest in corporate bonds and how yields compare with other mainstream assets

WHY INVESTORS INCLUDE CORPORATE BONDS IN THEIR INVESTMENT PORTFOLIOS

Survey of Australian high-net-worth individuals



Deloitte 2018

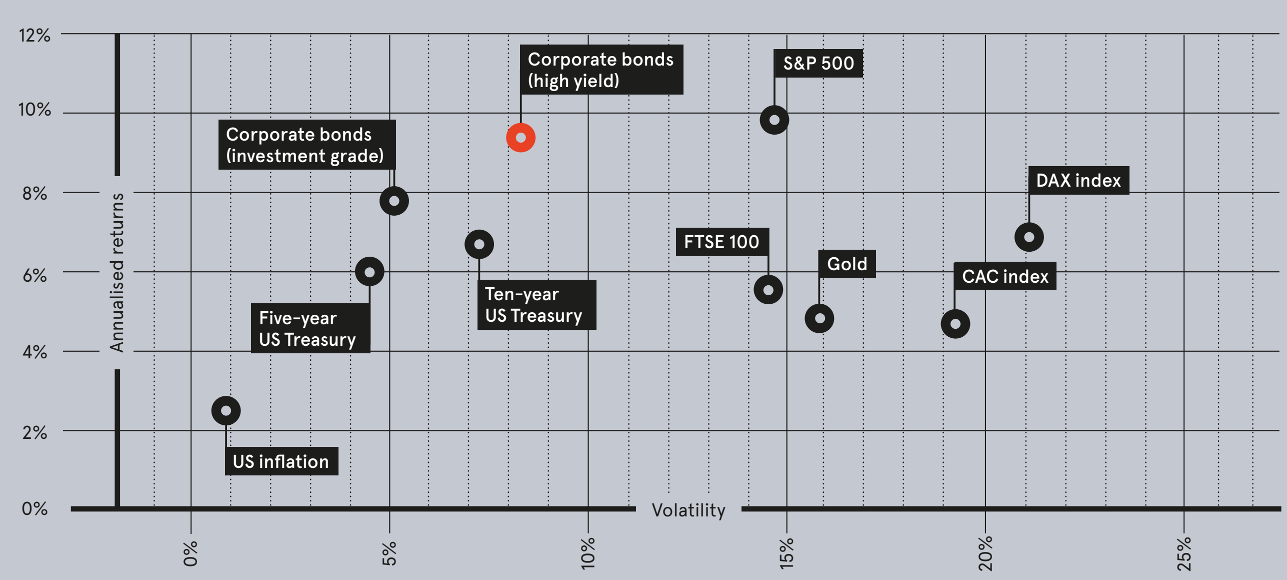
WHY BONDS ARE MORE PREDICTABLE THAN EQUITY

BONDS	EQUITY
Regular interest income	Uncertain share price growth and dividend
Principal repaid at maturity	No guarantee of return of capital
Fixed rate of income	Uncertain dividend income
Defined investment timeframe	No specified timeframe

RISK V RETURN CHARACTERISTICS OVER THE PAST 25 YEARS

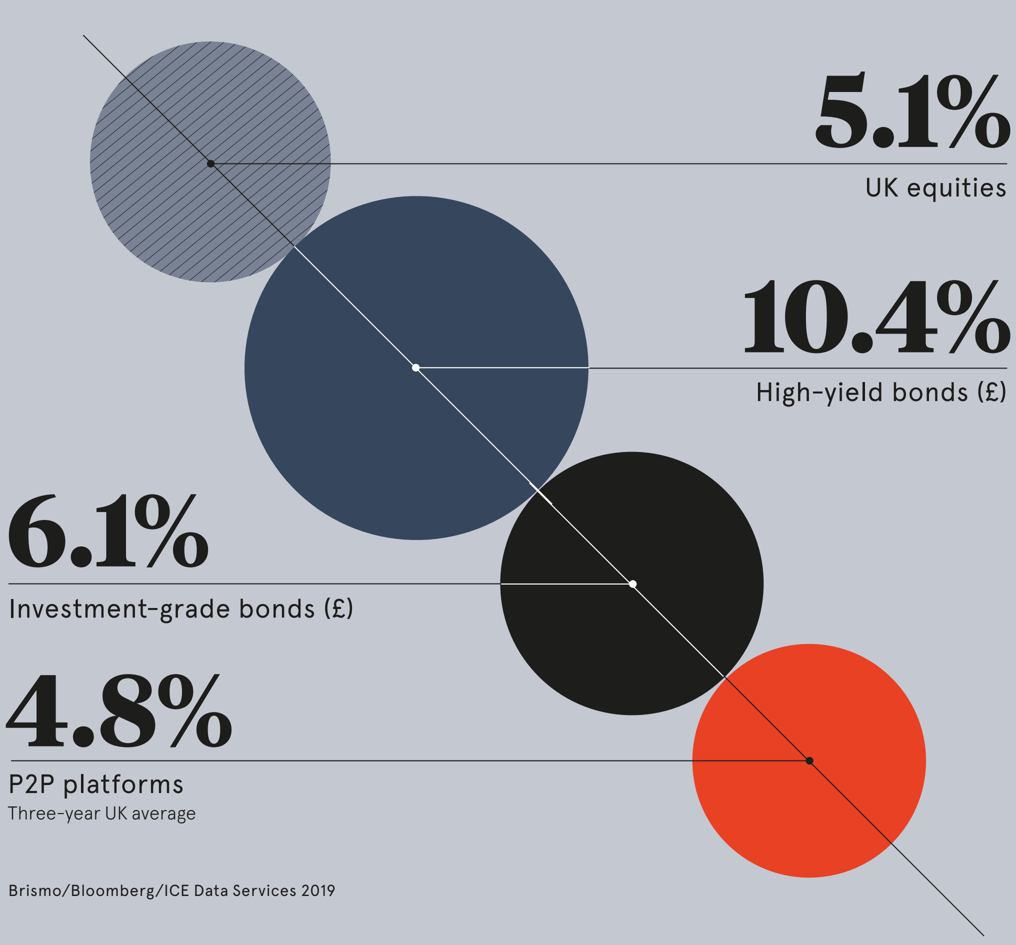
Annualised returns based on monthly returns from 1990-2015

WiseAlpha/Bloomberg/J.P. Morgan 2019



BONDS YIELD SUPERIOR RETURNS

Average annual return

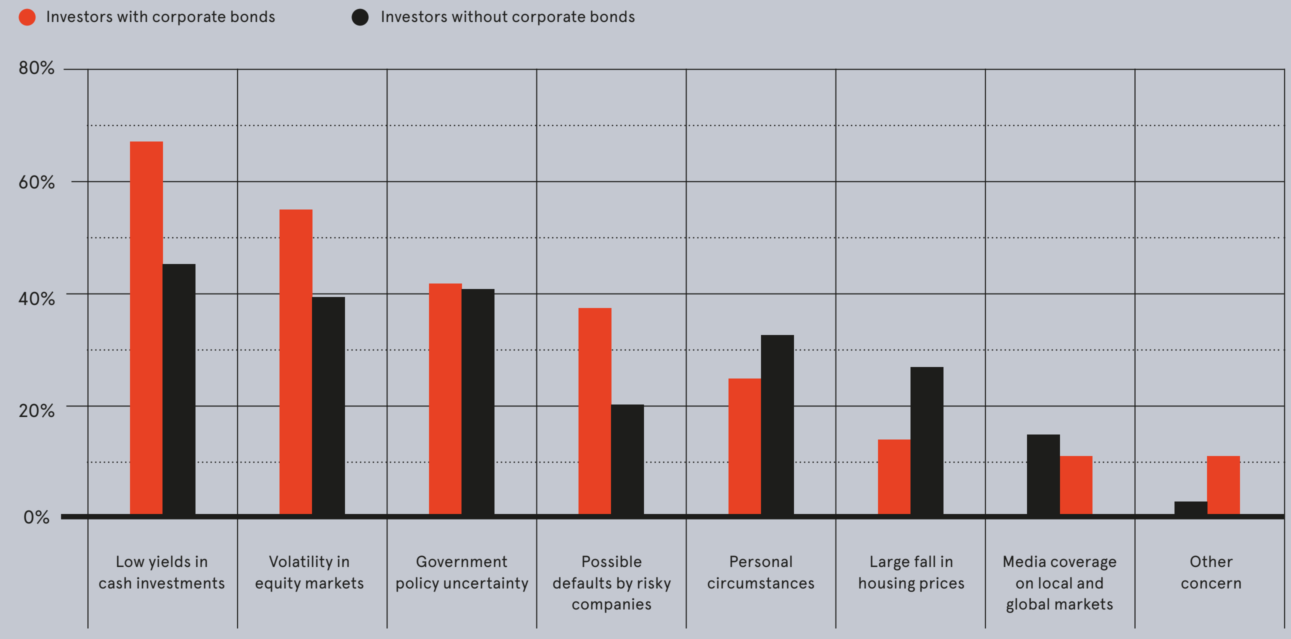


Brismo/Bloomberg/ICE Data Services 2019

CONCERNS ABOUT THE CURRENT INVESTMENT ENVIRONMENT

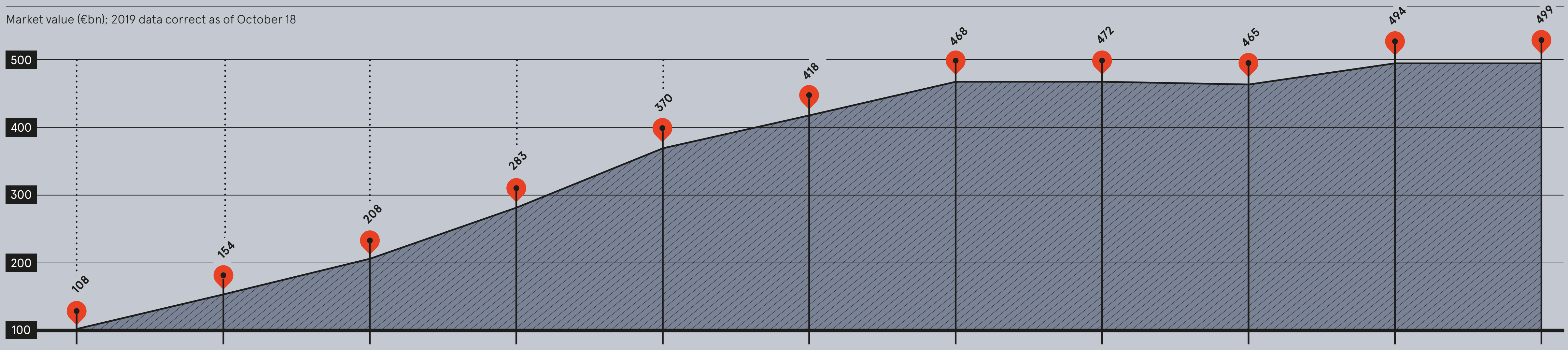
Survey of Australian high-net-worth individuals about their wider investment concerns

Deloitte 2018



GROWTH OF THE EUROPEAN HIGH-YIELD CORPORATE BOND MARKET

Market value (€bn); 2019 data correct as of October 18



Credit Suisse 2019

INVESTORS

Why DIY investors are on the rise

Self-directed investing, where investors create and manage their own portfolios via an online platform, continues to grow as individuals are able to better control their investments and save on costly advisory fees

Marina Gerner

In so many aspects of life, the internet has given us the tools to take matters into our own hands. Whether you'd like to find the love of your life or fix a leaky tap, the digital world might be the place to look. The same is true for personal finance.

The world of investment is no longer limited to a small group of cognoscenti. It's undeniable that new technologies and platforms have levelled the investing playing field, enabling a saver who historically would have just kept cash in the bank to invest without consulting a financial adviser. So what's attracting people to go down the self-directed route?

DIY investors typically create and manage their own investment portfolios, as opposed to going to a traditional broker or money manager. The barriers to entry are low, as many online investment platforms have a threshold of only £25 or £50 a month for people to start investing.

It's not surprising the market of online investment platforms has doubled from £250 billion to £500 billion assets under administration between 2013 and 2017, with 2.2 million more customer accounts opened, according to the Financial Conduct Authority.

The two main reasons why people become DIY investors are cost and control. "As adviser commissions have been banned and replaced with more explicit fees, financial advice is increasingly a luxury for those with over £100,000," says Holly Mackay of personal finance website Boring Money.

Financial advice can cost anything from £50 to £250 an hour. And if you leave your investment management to others, there is a charge, which is likely to be an initial fee of between 1 and 3 per cent and an ongoing charge of between 0.25 and 1 per cent of your assets invested, according to consumer association Which?

Those who go down the DIY route will often invest in funds or trusts, which are like baskets of shares managed by a professional, rather than the individual shares of companies. This makes investing much easier. It's also possible to buy passive funds, which are not managed by a person, but simply follow the index of a market.

Research has shown that many professional investors don't outperform the market, so it can make sense to simply invest in a product that mirrors the market. In one high-profile case, Warren Buffett, the world's most famous investor, hatched a million-dollar bet with the money management firm Protégé Partners. He bet that over ten years an index fund, which passively invests in the S&P 500, will perform better than five active funds picked by the company. And he won.

Who is the typical self-directed investor? "In the past, it was a fairly safe bet that a DIY investor on either side of the Atlantic would have shared a number of depressingly familiar characteristics: invariably white, 'wasp', middle aged, generally male," says Andrew Craig, author of *How to Own the World*, an accessible guide for those who want to become DIY investors.

Charlie Musson, of investment platform AJ Bell, echoes this observation. "Our typical DIY investor is male, aged 44 with a portfolio of around £90,000. However, we have seen the number of female customers increase recently and about a third of our customers are now women," he says.

It is fair to say the cliché is gradually evolving. Mr Craig says: "There is no question that interest in investment is growing among women and younger people." He cites the FIRE (Financial Independence Retire Early) movement as an example for how investing is reaching a much wider audience, slowly but surely.

DIY investors are likely to be a little younger than a decade ago, Ms Mackay agrees. "Robo-advice, better digital solutions and lower entry amounts have encouraged a younger audience," she says.

Robo-advisers have not had the runaway success some expected. Nevertheless, the world of investments continues to open up online.

DIY investors will typically have riskier portfolios than their advised peers, favouring shares over bonds, and spicier regions and sectors, Mr Mackay argues. What's more, DIY investors check their accounts more regularly with 63 per cent logging in at least once a month.

Mr Musson observes: "DIY investors on AJ Bell tend to buy shares and corporate bonds directly for about 40 per cent of their portfolio and invest through funds, trusts and exchange-traded funds for around 50 per cent." The remaining 10 per cent tends to be in cash, including dividends from existing investments.

More than 15 per cent of all trades are now placed via mobile although the main bulk of research is still done on a desktop, according to Boring Money.

The majority of investors invest in funds or trusts. But Mr Craig says: "Sadly, too many millennials in particular have bypassed all the above in favour of ploughing all their money into crypto. I believe this will have disastrous results for the majority of them for the simple reason that the more volatile an asset class is, the more likely people will lose money, regardless of the overall direction of travel."

Given that inflation erodes the value of money over time, investing is a beneficial DIY skill to have. After all, the stock market is, simply put, a place where companies raise money from people and institutions to grow their business. As the global economy grew by 3.7 per cent in 2018, those who invested in the stock market could share in this growth.

While investing in stocks puts capital at risk, research shows that despite ups and downs, stocks generate much higher returns than saving accounts over the long term. According to the *Barclays Equity Gilt Study*, UK stocks have returned around 5 per cent a year, above inflation, since 1999.

What are the implications of people making decisions without seeking advice from a financial professional?

"Financial advice can be very valuable and is often the right course of action for most people. However, some people don't want advice or can't afford it, and many simply enjoy investing and want to do it themselves," says Mr Musson.

Mr Craig adds: "For someone proactive and willing to do a modest amount of work and research, the implications of making decisions without using a financial adviser are actually pretty likely to be positive. This will clearly remove a layer of significant cost and sidestep the risk of using a poor-quality adviser of which there are many."

While much of the industry is shrouded in jargon, successful investing relies on a few general principles that DIY investors can learn. More than anything, having a wide range of diversified investments – shares, bonds, property and commodities – from all over the globe is key.

For a person in their twenties, thirties or forties, it's relatively easy to set up a DIY investment strategy. Once they're closer to retirement and have built up a decently sized pot, it makes sense to hire a financial adviser for retirement and tax planning.

As long as investment platforms and tools keep evolving along with financial literacy, DIY investing is set to grow.

Making informed decisions

How do DIY investors decide what to invest in? "Consumers often believe they are self-directed, but closer analysis reveals a more complex reality," says Laura Varas, chief executive and founder of Hearts & Wallets, a data and consulting firm. They find ideas in financial publications, online and also place their trust in advice from friends and family.

As Ms Varas observes: "People take advantage of the abundance of resources – digital, friends and family or a trusted adviser – to make informed decisions. The type of 'hybrid' behaviour, combining technology and people, continues to become more common."

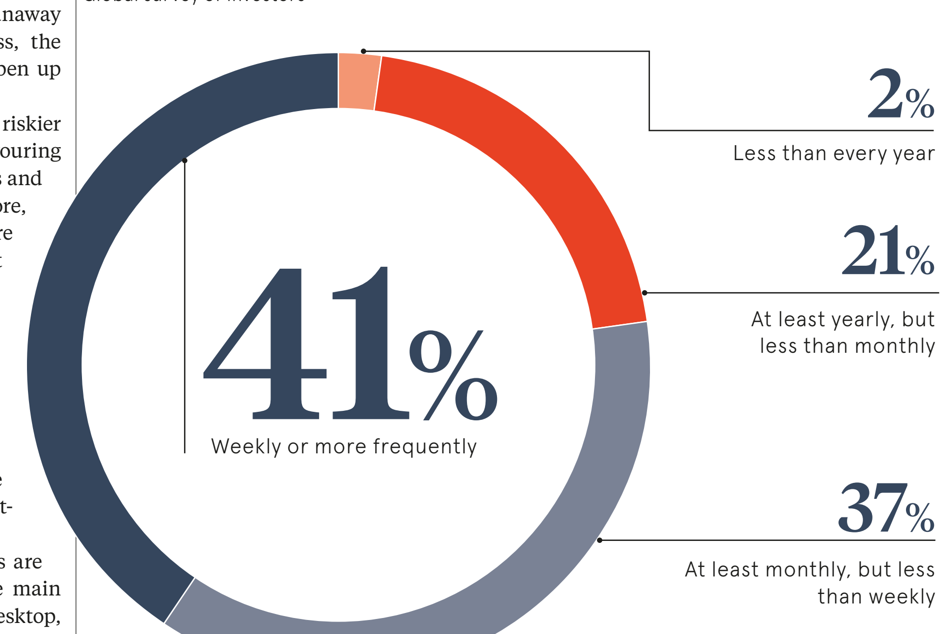
More than half of all investors (57 per cent) rely on online sources of information for investing advice, according to a large-scale survey by Hearts & Wallets. Family members are another important source of advice. Some 18.7 per cent of self-directed investors say they "usually" consult family, 34.1 per cent "sometimes" turn to family members and 9.3 per cent mainly turn to family members for investment advice. Figures for asking friends are similar, but lower.

In addition, many platforms provide so-called "best-buy" lists of funds across asset class. These lists intend to make investing easier by narrowing down a universe of thousands of investment funds. They don't count as financial advice and aren't regulated as such. Some 17 per cent of DIY investors rely on them, according to the Financial Conduct Authority.

Such lists have come under fire this year, when Bristol-based Hargreaves Lansdown kept Neil Woodford's flagship Equity Income Fund on its list, despite recognising there were issues with its liquidity. This has prompted questions on whether regulators should curb the use of lists and whether platforms need to be more transparent on how they select funds.

HOW FREQUENTLY INVESTORS CHECK THE VALUE OF THEIR INVESTMENTS

Global survey of investors



Schroders 2019

RETIREMENT

How bonds fit into retirement

Additional retirement investments are becoming increasingly essential for savers, but few would think to consider corporate bonds as a viable option

Nicola Tavendale

One of the biggest risks to a retiree is outliving their savings, according to a recent World Economic Forum report *Investing in (and for) Our Future*. Yet the same study found that the world's collective retirement savings gap, which stood at $70 trillion in 2015, may exceed $400 trillion by 2050.

Most savers are now all too aware of this risk and, where possible, have made additional investments for their retirement, though mostly through more mainstream vehicles, such as workplace defined contribution schemes or stocks and shares individual savings accounts, or ISAs.

However, with stocks and shares becoming increasingly volatile due to a host of macroeconomic events, and persistently low interest rates making it difficult to generate sufficient income from savings accounts, the high income and strong performance of corporate bonds is likely to interest many retirement investors.

Barclays calculates that sterling investment-grade bonds returned 6.1 per cent annually from 2000 to 2019, compared to the FTSE 100 at 5.1 per cent. This is not to mention the superior performance of high-yield bonds, which returned 10.4 per cent, according to Bank of America Merrill Lynch.

"The idea of holding corporate bonds in your pension is an interesting one. I have met very few people who hold individual corporate bonds in a pension," says Michael Martin, head of the private client team at Seven Investment Management.

"Instead, they might have chosen to hold a corporate bond fund. More likely, however, is that they will have given very little thought to asset allocation within their portfolio and will simply have bought a variety of funds and, if those funds happen to have some bond exposure, then so be it."

Nevertheless, according to Willis Towers Watson, the UK pension fund industry allocated a substantial 53 per cent of funds to bonds in 2018.

Jack Bogle, founder of Vanguard investments, recommends holding "roughly your age in corporate bonds minus 10". For example, if you are aged 50 then 40 per cent of your portfolio would go into bonds, as you have more wealth to protect and less time to recoup unexpected losses on the stock market. Simply put, this means that the older you get the more you should rely upon income-generating assets from your portfolio ahead of retirement.

The World Economic Forum also argues that investment policy can have a significant and positive impact for those savers who are consistently contributing and have built up an asset base. It advises savers to invest a significant allocation into diversified portfolios that are expected to generate strong returns over the long term.

Individual investors might also consider whether the use of a self-invested personal pension (SIPP) might help them to manage their retirement savings more proactively by enabling them to invest in a range of assets, including corporate bonds. This might also help redistribute their investments in an attempt to navigate macroeconomic events.

SIPPs also have the benefit that investments in it are free from income tax and capital gains tax and you receive tax relief on your pension contributions.

Some SIPP administrators will enable access to corporate bonds or individuals can use a financial adviser, investment manager or stockbroker to access the bonds directly.

According to the UK's Money Advice Service, there might be some risk with corporate bonds, though they are generally still considered less risky than shares. Though it recommends investing in securities from a number of different companies so investments aren't tied to the fortunes of one company.

For those with access to the full risk spectrum of corporate bonds and a mindset of consistent income-based returns it is not uncommon to see corporate bonds forming the largest part of a portfolio. And a SIPP can be a useful tool for those looking to generate strong income tax efficiently.

57% of 27,000 people surveyed worldwide do not hold any form of investment

64% of those non-investors find information about investing difficult to understand

BlackRock 2019

OUTLOOK

Could lightning strike twice?

After a stellar year for corporate bond returns, investors will be looking to repeat the feat, but how realistic is this in the current market? Here are some opportunities for novice, experienced and more adventurous investors

Joe McGrath / Gren Manuel

Bond investing is common in some European countries but less so in the UK, which means a beginner cannot easily turn to friends or family for advice. A little knowledge goes a long way.

Those who have already taken the plunge have seen attractive returns. The S&P UK Investment Grade Corporate Bond Index, which measures the total return from investing in a basket of bonds from the most creditworthy UK companies, returned 10.49 per cent in the year to October 14. Elsewhere, the returns were even higher: the S&P 500 High-Yield Corporate Bond Index, which tracks the returns from US companies that haven't made the top tier of creditworthiness, returned 12.04 per cent over the same period.

This higher return from less stable companies illustrates the golden rule of bond investing: better returns come from higher risks. Firms with strong cashflows such as Vodafone need pay only around 3 per cent to get investors to buy their bonds; smaller companies, or those whose finances are less robust, may need to pay three or four times this figure to compensate investors for the risk that they may miss interest payments or even not return the capital.

Is the good run for corporate bonds over? "We can't promise another year like this," says Stephen Thariyan, co-head of developed markets at BlueBay Asset Management. But he indicates that the market does not yet appear to have peaked.

Investors should remember that corporate bond investing is very different from products marketed as "savings bonds" by banks and building societies. Those products are covered by the Financial Services Compensation Scheme, which broadly means that if the issuer collapses then the government will compensate savers up to £85,000. For corporate bonds, like shares, the degree of safety is down to the investor's own skill.

Opportunities for the novice

Traditionally, British investors wanting to invest safely in corporate bonds have been advised to buy bond funds. These bring the advantage of diversification: one company running into problems will make only a minor dent in the overall return.

The problem with bond funds, however, is simple: fees. In a low interest rate environment like today, the fees levied by a bond fund manager can eat up a tenth, a fifth, or even more of the returns.

Investing directly in bonds strips out most of the fees, and allows the investor the flexibility to adjust their risk/return ratio whenever they want. The novice investor, though, still needs to reduce risk: first, by diversification, and second by choosing stable companies with good cashflow.

Some investors like to invest in household names, which is a good starting point but not a substitute for proper research. We live in an era of digital disruption where high street names such as Thomas Cook and Mothercare can disappear overnight, making both shares and bonds worthless.

Any large company bond will have at least one credit rating – an independent assessment of the company's ability to pay in the same way that restaurant guides assess restaurants' ability to make good food. Unfortunately, rating corporate bonds is more complex than rating steak tartare, but even a basic understanding can serve as a vital warning signal. A firm may have a great business but still have substantial repayment risk, for instance if it has overextended itself buying other companies.

Investment-grade companies with strong credit ratings are a sensible choice. Those tempted by the extra risk and return of higher-yielding bonds should look to see if those bonds are "secured". Bonds that have this label have security over the company's assets, usually property, a concept similar to a domestic mortgage. If the company runs into trouble, holders of secured bonds have first claim on the funds when these assets are sold and therefore a better chance of getting their cash returned.

It's also important to think about scenarios. Bonds may be safer than shares if the global economy slows, but some are clearly safer than others.

Opportunities for the bolder

Under the golden rule, the way to boost returns is to take on more risk. This may mean buying bonds from firms whose financial position is less strong. But it may mean buying bonds with a longer duration.

Most bond investors buy bonds with the intention of holding them until the company returns the capital, and the longer this wait then the longer the investor is exposed to risk. As an example, Netflix has issued bonds in euros that won't repay the capital until 2029. A lot can happen in the world of digital entertainment in a decade.

The way to reduce this risk is, again, diversification and building a portfolio. But to make this diversification work, they need to be different types of companies. Just like a share portfolio, if all the companies in the portfolio are exposed to the same risk – for example, retailers exposed to the decline in the high street – it's not true risk reduction.

JP Morgan Asset Management's investment-grade corporate portfolio manager, Andreas Michalitsianos, says investors may want to consider some of the opportunities in the financial sector. It may seem counterintuitive – some banks went bust in the last downturn in 2007 – but banking rules have been toughened and most experts agree banks are much safer than a decade ago.

High-yield bonds issued by banks and financials are popular among some investors given the strong financial performance of the sector, high coupons and medium-term duration of the bonds.

Opportunities for the brave

While buy-and-hold may be the simplest way to invest in bonds, this is not how the big players work. They take advantage of the price movements as a company's creditworthiness changes or fluctuates in response to events, such as changes to profit levels or taking on debt to buy other companies.

For instance, Metro Bank's bonds at present pay a high rate of around 9.5 per cent as the company has had a series of well-publicised accounting problems, so it has had to pay a high rate to entice investors to lend. If the bank recovers, the price at which the bonds change hands between investors will continue to soar.

Buy-and-hold investors will see no change to their interest payments, but experienced investors can take advantage of these price movements to make shorter-term profits almost like in the stock market.

Another example is Aston Martin, which in September issued bonds at a very high rate of 12 per cent amid falling sales. If it navigates Brexit and its new models prove a hit with drivers, its creditworthiness should improve and the price of the bonds should rise. In these situations some professional investors see an opportunity to trade both the bonds and the shares to either hedge their risk or magnify their returns

Interested? These kinds of investment require a lot of research, both to understand the mechanics of the market and then around each purchase. And it also brings high risk: if a company's creditworthiness deteriorates then the price of its bonds can collapse. ●

APPETITE

Yield-hunting drives corporate bond issuance frenzy

The boom in corporate bond issuance in 2019 has been driven by both historically low funding costs and a move away from the traditional sources for funds

Josie Cox

As bankers and investors returned to their desks after the summer break, many didn't even have time to dust off their keyboards before being drawn into a full-throttle corporate bond market frenzy.

In America, in the space of just five days, almost 50 companies across a spectrum of industries issued bonds, raising well over $70 billion of debt. Activity in Europe wasn't quite able to eclipse volumes in the United States, where the market is historically much larger, but bankers in London, Frankfurt and Paris also experienced a frantic return to work, courtesy of companies such as Glencore, British Telecom, Peugeot and BMW pricing bonds in euros or pounds.

September is traditionally hectic, but this year it was unparalleled. Total global issuance of corporate bonds during the month was $434 billion, beating a previous monthly record set in March 2017, according to capital markets data provider Dealogic.

Frazer Ross, Europe, Middle East and Africa (EMEA) head of investment-grade debt capital markets syndicate at Deutsche Bank, says that by the middle of October, year-to-date issuance of high-grade euro denominated corporate bonds was already up more than 30 per cent on the previous year's like-for-like level. Sterling volumes were up more than 40 per cent.

"Growth in issuance this year has been driven by historically low funding costs," Mr Ross explains. "These costs are low as government bond yields have been reduced given the broader macroeconomic slowdown and the subsequent rate cuts from global central banks."

He adds that, notably, record low yields had encouraged US businesses to issue euro-denominated bonds. According to Dealogic, around 25 per cent of all investment-grade euro-denominated corporate bonds issued this year have been priced by US companies, including AT&T, IBM, Coca-Cola and Colgate-Palmolive.

"In simple terms, what's driving the market is just a real hunt for yield," says Lloyd Harris, lead credit portfolio manager at Merian Global Investors, which has around £24.5 billion in assets under management. Mr Harris agrees that while low rates are the primary driver of issuance, there's also been a move away from loans and towards bonds as a result of stricter regulation since the financial crisis.

"In regulatory terms, it's just more onerous for banks to provide loans than it used to be, so that's supporting bond issuance too," he says.

That has also encouraged many businesses this year to add bonds to their capital structure for the first time ever. Debut issuers of corporate bonds include French software provider Dassault Systèmes and Italian football club Juventus.

During September, almost the entire German government bond curve was in negative yielding territory, which means investors were paying for the privilege of lending money. High-quality corporates, deemed to have a very low default risk, have also been able to issue bonds at negative yields, often with oversubscribed books. In fact, Tradeweb, a widely used electronic platform for trading bonds, indicated that around a third of all corporate bonds in Europe are now negative-yielding.

$434bn

total global issuance of corporate bonds in September 2019, the highest on record

Dealogic 2019

In early-October, even Greece, a country that received several bailouts during the eurozone debt crisis, sold three-month debt at a yield of minus 0.02 per cent.

Companies that have issued bonds with a yield below zero this year include Siemens, GSK, Merck KGaA and Orange.

Andrew Jackson, head of fixed income, at Hermes Investment Management, which manages more than £36 billion in assets, concedes that compensation for the risk of lending is at historically low levels, but says there is still a case for buying bonds.

"Because investing in cash gives rise to a negative return, $17 trillion of negative-yielding assets makes any positive yield look attractive on a relative basis," he says.

With debt being priced at such a ferocious pace, it may be pertinent to ask about the risks of companies that issue bonds over-leveraging and what impact this might have on equity valuations in the long run.

At Merian Global Investors, Mr Harris isn't concerned. "Despite issuance volumes being so high, it's not like there's been a wild wave of leveraging," he explains.

He says that particularly in Europe, companies tend to be conservative with their funding, which means they won't risk accumulating more debt than they might be able to service, even if market dynamics were to change abruptly.

Mr Harris also notes that, especially in America, a number of corporates have issued debt to fund share buybacks, which tend to bolster equity valuations.

"Far from being purely 'opportunistic', the vast majority of corporate borrowers tend to issue debt when they have cash needs," explains Sarwat Faruqui, co-head of international syndicate and head of EMEA syndicate at Japanese bank Mitsubishi UFJ. "On that basis, I don't think there are many treasurers who are raising money just because they can do so at compelling rates."

Ms Faruqui says one thing the conditions might influence is the duration of the bonds that are priced. In many cases, companies are issuing longer-dated bonds, which might actually protect their capital structures in the case of a downturn.

Mr Ross of Deutsche Bank agrees. "The majority of investment-grade borrowers are still only modestly levered and we have seen no signs of credit deterioration," he says. "Clearly if economic conditions deteriorate significantly or yields rise dramatically, this can change the picture. However, this doesn't look likely in the near future. Also issuers have many levers to pull to reduce leverage, like reducing dividend payments."

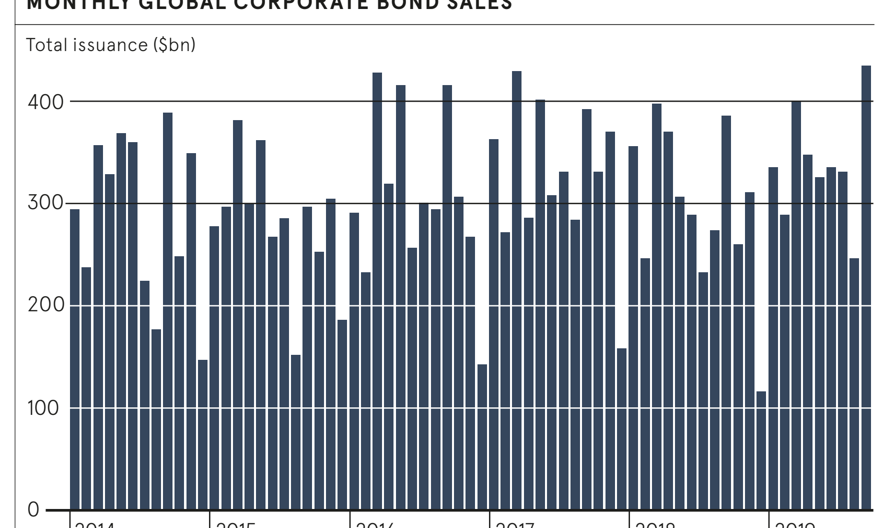
Going forward, and barring a major market shock, investors and bankers anticipate the pace of funding is likely to continue, though perhaps not quite at such a breakneck speed.

Mr Jackson at Hermes also points out that many of the highest quality companies, considered to be the least likely to default on debt, have already done all the funding they need to, locking in cheap cash for several years, implying the quality of borrowers is generally decreasing over time.

> "Almost the entire German government bond curve was in negative yielding territory, which means investors were paying for the privilege of lending

"I do anticipate that we'll stay busy," a debt trader at a large US-based bank, who prefers to remain anonymous, forecasts. "But at the same time, we are facing some of the most uncertain times in history, both geopolitically and economically. We've had a great run in recent years, but this year I think we'd all be wise not to spend our bonuses before we've made them." ●

MONTHLY GLOBAL CORPORATE BOND SALES



Dealogic 2019

FUNDING

Pros and cons: P2P lending v corporate bonds

While P2P lending has surged over the past five years, recent platform failures and high-profile declines by some in the sector bring into question the performance and risk profile compared to lending to more-established companies through corporate bonds

Nicola Tavendale

P2P lending

According to data from the Peer-To-Peer Finance Association (P2PFA), the sector's self-regulatory body, P2P platforms last year facilitated loans worth almost £3 billion in the UK alone. While still considered an alternative investment, the P2P market has been increasing not just in size, but also in sophistication and maturity.

"The appeal of P2P lending is the relatively high yield for a diversified exposure to small borrowers," says Rupert Taylor, founder and chief executive of Brismo, which provides standardised loan performance track records to help investors measure and compare return and risk.

"With P2P lending you are getting a very broad and diversified exposure to micro-loans. With corporate bonds not being offered in retail investor-friendly size, it is impossible to achieve diversification without buying a fund."

> **The more pressing issue is how to effectively improve transparency and help investors to understand the returns**

Venture capital firms may have good reason to be concerned about falling returns in the sector, particularly in light of Funding Circle's falling share price since the platform listed on the London Stock Exchange in October 2018. Although initially listed at a price of 440p a share, it dropped to a recent low of 88p and now trades around 100p, equating to a drop in valuation from £1.5 billion to £355 million.

According to Brismo's UK Marketplace Lending Index, returns across the sector as a whole have also fallen in a two-and-a-half-year period from highs of around 6.3 per cent in early-2017 to around 3.8 per cent in 2019.

However, it is very important that performance be considered in the context of overall returns across the financial markets, warns Mr Taylor. "Returns may be falling, but they're still very good in the current low-yield environment. A three-year UK government bond is currently yielding around 0.5 per cent. So 3.8 per cent net of losses, fees and so on for equivalent duration marketplace loans is still very attractive, despite the higher risk," he says.

"The real issue is not that returns aren't high enough, it's that it is difficult to understand and compare the performance of the different platforms. The more pressing issue for the sector is how to effectively improve transparency and help investors to understand the returns. The regulator will remain nervous and institutional adoption will continue to be narrow if investors cannot appraise risk and return."

Corporate bonds

A feature of the investment landscape for centuries, corporate bonds are much more of a known entity, both in terms of risk and for having a better established regulatory regime. Corporate bond issuance rose some $29 trillion in the ten years after the financial crisis, according to the McKinsey Global Institute.

Even so, corporate bonds continue to have a higher risk profile than that of other asset classes, for example government bonds, but will often offer greater returns as a result. The risk profile for corporate bonds is also less than that of other mainstream investment options, such as equities, or alternative investment vehicles, including P2P investment.

However, the mainstream corporate bond market is still dominated by institutional investors due to it having had a much larger unit size, which in turn has made it harder to secure diversified exposure, unless retail investors were willing to go through a fund, incurring fees.

"If you want more return then you have to take some risk, and it's a question of how much additional risk and how much extra return you get as compensation," says Brismo's Mr Taylor.

It's no coincidence that the market and regulatory failures preventing ordinary retail investors access to the main corporate bond markets have contributed to the rise of alternative fixed income, such as P2P lending and SME mini-bonds, which have exploited the interest income savings gap brought about by the era of low interest rates following the 2008 financial crisis. ●

RETAIL BONDS

Has London ORB achieved its goals?

It was meant to provide corporate issuers with an efficient market to distribute bonds to private investors, but issuance on the London ORB has slowed, while other innovative forms of financing have boomed

Daniel Lanyon

A silver lining after the storm clouds of the 2007-08 financial crisis was that it triggered a wave of financial innovation. Over the following decade, a period that also saw exponential growth in the smartphone and cloud-computing markets, investors benefited from a boom in new ways to seek a return, many of which claim to democratise investing.

One of the first UK milestones in this trend was the launch of the London Order book for Retail Bonds (ORB) by the London Stock Exchange in 2010, which created a venue specifically for retail investors to buy into corporate bonds. While extremely limited in terms of the size and number of bonds available compared with the main institutional bond market, it was the first genuine attempt to bring the corporate bond product to UK retail investors, who had long been largely excluded from the market due to prohibitive tranche sizes, untransparent pricing and institutional preference in allocations. But is it still working?

Before that question is answered, it's worth taking a swift step back because the ORB is not as well known as it should be. For those seeking an income from lending in the past 30 years, one of the most sophisticated and popular ways has been the bond market. Before its launch, however, it was rare for individual investors to put money directly into bonds.

This was, and still is, because bonds are sold "over the counter" in the main institutional bonds market between City dealers and brokers in large tranches usually starting at £100,000. This effectively ruled out retail investors. Unless you had a portfolio of several million pounds, it was impossible without resulting in a severe lack of diversification. This meant you had to pay someone else to do it for you, normally a bond fund manager charging you an annual fee on assets.

> **The ORB market has become a bit niche, rarely mentioned, so investors don't know it exists and what they can invest via it**

The London Stock Exchange launched the ORB amid overt demand from private investors for easier access to trading bonds. It offered electronic trading in UK government bonds, known as gilts, and corporate bonds in small fractional denominations of £1,000, initially including some of the UK's most well-known and trusted firms, such as Vodafone, GSK, BT and Marks & Spencer.

On the flipside, the ORB provided corporate issuers with an efficient mechanism to raise money via bonds, helping stimulate new issues and widening the pool of investors.

Transparency and openness was a major goal with all participants simultaneously able to access executable prices and have equal opportunity to trade at the best available price, as well as a high level of regulatory oversight and better liquidity. Retail investors were also able, for the first time, to enter orders into the order book giving the opportunity to take or make a price in a security. This, in turn, creates a proper secondary market.

Adrian Lowcock, head of personal investing at Willis Owen, says to some extent the London ORB market has achieved its aim of creating a venue for listed retail bonds, as the alternatives are privately issued SME mini-bonds, which are unregulated and illiquid.

"The creation of ORB has arguably stemmed the size of this market. But, of course, it wasn't ORB's primary job to do that," he says.

ORB has had to compete with other financial innovation, such as P2P lending, crowdfunding and digital corporate bond market platforms, which have "done a great job" of engaging with new audiences, and a new generation of investors, and taken some of the attention away from ORB, says Mr Lowcock.

The future looks uncertain though, as the issuance of bonds on the ORB market has slowed down dramatically in recent years and ground to a halt in 2019. "This is perhaps a reflection of the fact that the wider UK bond market has also got a bit smaller as well. The ORB market has become a bit niche, rarely mentioned, so investors don't know it exists and what they can invest via it," he says.

Luigi Algisi, credit analyst at Canaccord Genuity Wealth Management, says the London ORB market is not huge. The number of issuers has been limited and you are now more likely to find smaller companies issuing retail denominated bonds. He does think it is useful for some clients, however. "Some of the bonds we buy are listed on the ORB rather than the main market due to being retail bonds with small minimum size," says Mr Algisi.

Scott Beattie, head of debt capital markets at Peel Hunt, which has carried out retail bond issuances for a number of firms over the past two years, including Burford, International Personal Finance and Lendinvest, is more sanguine. He says the ORB market continues to be active: "It still has an important role to play and is particularly valuable for smaller companies, which cannot access the wholesale market because their issues' sizes are too small."

The original aims of the London ORB have been partly achieved; but the process of investing has only become tougher as income yields for retail bonds broadly have become more depressed, owing to quantitative easing by central banks.

However, according to WiseAlpha founder Rezaah Ahmad, institutional bond markets offer a wide range of risk and return, compared to retail bonds. "With bond pricing driven by sophisticated market participants that assess both risk and return, it isn't a coincidence risk-adjusted returns continue to be strong and issuance volume has soared over the last decade."

Despite the slowdown in the London ORB, retail investors starved of corporate bonds and too small to access the main bond markets need not despair as emerging retail bond trading venues open up access to the institutional market and the vast array of bonds issued by the world's largest companies ●

Top three retail bonds traded in 2019

Enquest: £878,278

The North Sea oil exploration firm was the most traded ORB London bond in 2019 thanks to improving financials and production levels, following its financial restructuring in 2016 which saw its bonds drop to below 30p at the time. It hit a peak of activity in April, amid growth in volatility in the price of oil on global markets and the spectre of sanctions against Iran being a boon for UK oil firms.

Burford Capital: £781,071

Litigation financier Burford's various bonds rocketed to the top of the most traded in August when the firm was hit by reports, which it claimed were "false and misleading", from a US hedge fund that alleged it was mis-stating key numbers to investors. Its share price fell 65 per cent in just a day, but has since recovered.

Retail Charity Bonds: £1,036,776

Bonds issued by this the umbrella platform, which helps various charities raise money, were the third most traded on the London ORB in 2019. April and May were peak months, with its Golden Lane bond, established by the Royal Mencap Society to provide quality homes for people with learning disabilities, the most traded in the latter month.

Data from the London Stock Exchange, correct at November 11, 2019

CASE STUDY

Is the borrowing boom a cause for concern?

The recent collapse of heavily debt laden Thomas Cook was bad news for customers and bondholders alike. In a low interest rate environment that has encouraged increased borrowing by some firms, investors need to be vigilant

Raconteur

Lending is easy. Getting it back is not always certain. While this might seem obvious, it is important to recognise that bonds, like equities, are investments and therefore carry risk. Companies can default on their loans or bonds if trading or cashflow weakens, which could lead to losses on the face value of the bond.

According to data from the Insolvency Service, company insolvencies hit a five-year peak in the first three months of 2019 and some analysts have started to point to rising debt levels, particularly in sectors such as energy, media and retail. While SMEs and startups have been the most vulnerable, even large corporates have issues from time to time. Too much debt and/or bad decision-making (often correlated) are some of the key reasons companies default.

This year has brought one high-profile firm's collapse in particular into sharp focus. Thomas Cook, a once treasured UK brand with hundreds of years' heritage, was heavily debt laden and trying to secure new funding when it went bust in September. It ceased to operate almost overnight, leaving 150,000 customers stranded abroad. And this wasn't just bad news for travellers and employees, but also for equity holders who were wiped out entirely and bondholders who face steep losses as the company's assets are liquidated.

Thomas Cook is by no means the only well-known firm that has taken on more debt in recent years, but could it be a harbinger of more to come? And what strategies could investors employ to hedge their risk or even make money from these types of situations?

The past ten years have brought record-low interest rates and with this has come a boom in borrowing by some firms. Listed corporates in the FTSE 350 are no exception. They have become increasingly more sophisticated in their use of debt to optimise their capital structures, borrowing to drive growth without diluting equity, or borrowing at the behest of aggressive shareholders looking for the company to buy back stock or raise dividends.

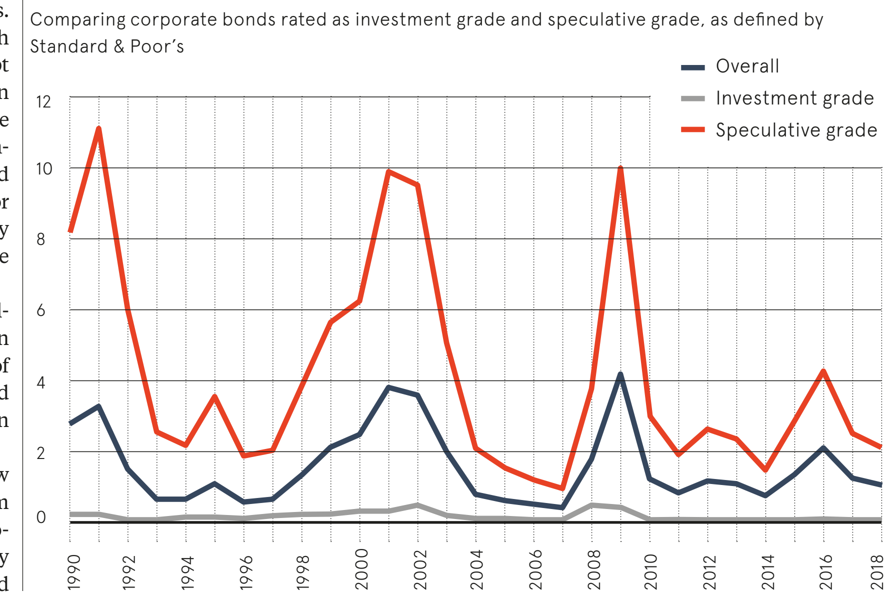
A blog post from economists at the Bank of England earlier this year pointed to the rise in the volume of corporate bonds that have BBB rating, the lowest level before bonds move from investment-grade into high-yield status.

It said the size of the sterling investment-grade corporate bond market has increased six-fold since 1998 to £375 billion. Over the same period, the share of BBB-rated bonds, the bottom rung of investment grade, has increased from 8 to 50 per cent of the market. This means the market value of the sterling BBB bonds is bigger than in 2008 and eight times that in 2002. The worry echoes similar calls from other international organisations that globally some bond markets may be in a bubble. For investors wanting to avoid the next Thomas Cook, this is worth keeping in mind.

Bondholders can look to hedge their bets if they smell a brewing cash crunch or debt crisis by either selling out or shorting the equity to offset any losses if a company goes bust or its market value declines over a sustained period. As bond trading becomes mainstream among retail investors, learning how to trade both the bonds and equity of a listed company could become more important ●

GLOBAL DEFAULT RATES BY CREDIT RATING (%)

Comparing corporate bonds rated as investment grade and speculative grade, as defined by Standard & Poor's



Commercial feature

FUNDING

Why companies turn to the bond market

Corporate bonds are a way for companies of a certain size to raise money for a host of reasons, ranging from buying or merging with another company, to expanding overseas or investing in new equipment or factories

Daniel Lanyon

Aston Martin

Luxury carmaker Aston Martin, a marque favoured by royals and James Bond alike, launched a high-profile initial public offering (IPO) in a bid to raise money to fund expansion. But since the 2018 IPO the company has suffered an increasingly depressed share price and this year it turned to the corporate bond market to raise a further £120 million. Aston Martin is set to pay 12 per cent on its secured bonds which mature in April 2022, a rate that raised eyebrows among some investors.

The carmaker is a case in point of why companies issue bonds. It said it needed the cash to pay off both short-term debts and further develop its next generation of cars over the coming years. The 12 per cent yield is high and clearly reflects the concerns of creditors who have seen the firm's share price since its IPO steadily decline.

Nonetheless, the firm did choose to access financing via corporate bonds over other forms of debt in a bid for long-term sustainable growth. The bonds, however, were put under immediate pressure over the summer as it saw a downgrade to its credit rating by Moody's from B2 to B3.

Aston Martin's longer-term target, which the debt will be partly used for, is to make a success of the lucrative SUV market with the launch of a new model at the end of 2019. But for now the market is both at least a little stirred and shaken by this strategy.

LendInvest

A digital platform connecting those who want to invest in short-term bridging and development loans backed by property with would-be borrowers, LendInvest is squarely in the fintech lending business. Since its launch in 2008, the privately listed company has enjoyed growth in alternative finance, which disintermediates banks to provide capital where it is needed.

The non-bank lender, however, chose to use the London ORB (Order book for Retail Bonds) market in 2017 and 2018 to launch a listed retail bond to help it fund plans to grow origination volumes. Its first taste of the bond market came as the firm decided to shutter its peer-to-peer business to retail investors.

Like many other firms involved in the alternative finance market, growing loan originations is important for LendInvest and it certainly was unusual among its peers that the firm chose the retail bond route – Funding Circle launched its own investment trust to grow its lending – but the bonds have held up.

LendInvest's foray into bond issuance was oversubscribed in both years and the firm has been growing strongly ever since. In 2018 it clocked up its fifth year of growth in both profits and revenue. Its loan originations, meanwhile, jumped a sizeable 40 per cent compared with the previous year.

Domestic & General

With one in three UK households protecting their consumer electronics products using the warranties and services provided by Domestic & General, the company is a true giant in the UK market.

Originally bought in 2013 by private equity giant CVC Capital Partners, it tapped the high-yield bond market to help fund the buyout, most recently issuing a £305-million 6.5 per cent senior secured bond and a £150-million 9.25 per cent unsecured bond to refinance its existing bonds.

Private equity companies usually fund the purchase of companies with a mix of their own equity and debt funding, and sometimes split the debt funding into more than one tranche to enable them to target investors with different risk appetites. They usually issue in the high-yield bond markets working with large global banks to roadshow the bonds. And retail investors are often left looking in from the outside as institutional investors are primarily targeted.

The company has generated a strong and consistent financial performance under CVC's ownership in recent years. Its revenues and cashflow have grown every year over the past five years and it reached 16 million customers by March 2019.

With strong growth in its international operations and an upcoming entry in the US market, it is thought that Domestic & General will continue to use the bond markets to fund its overseas expansion strategy and optimise its capital structure.

Tesco

With its origins in Hackney 100 years ago, Tesco has become one of the UK's largest and best-known companies, and no stranger to the corporate bond market.

It was one of the first bonds to be listed on the London ORB market in 2010 and went on to also offer bonds specifically aligned to its banking arm Tesco Personal Finance.

The UK's largest grocery retailer, Tesco is listed on the FTSE 100 Index and has broadly been seen as quintessential blue chip. This was tested, however, in 2015 when it lost its investment-grade status, after a rating agency downgrade. The firm was embroiled in financial difficulty and the heaviest loss in its history,

But in 2017 Tesco said it would start paying down some of its debt and make use of other forms of financing. The company did return to the bond market for the first time in a decade, however, with a £400-million six-year bond earlier this year, signalling it was feeling more confident of its financial footing.

Netflix

As one of the FAANGs (Facebook, Apple, Amazon, Netflix and Google), the firm has been one of the strongest-performing stocks since the financial crisis. Much of its stellar growth has come from its borrowing via bond markets in this period to fund content creation, which lies at the heart of its business model.

Competition, of course, has been increasing more recently with Disney, a powerful potential future adversary, entering the streaming business. Netflix, responding in kind, is looking to raise $2 billion of new bonds to fund a content push to help bolster its chances of seeing off competitors new and old in the war for attention from subscribers.

Its latest earnings exceeded estimates from many analysts and the new cash is likely to be raised to follow its strategy of using debt to fund content, both through acquisition and original productions, which has seen it build up a $13.5-billion debt pile since its first move into the bond market in 2009.

The company is eyeing profitability one day, but in the meantime it wants to produce a lot of movies and box sets, and isn't afraid to use the corporate bond market to make this happen. ●

The new investment opportunities enabling individuals to grow their money consistently

Against a backdrop of widespread macroeconomic uncertainty and volatility, cutting edge investment strategies and technological innovations provide hope for investors. These new routes to growth will be showcased at a major event in London in March

Causes for concern within the global economy are currently in plentiful supply, both for individual and institutional investors. The constantly talked about threat of a deeper global downturn, Brexit uncertainties, the US-China trade war and different regional tensions are just a few of the factors contributing to a real sense of volatility.

There are, nonetheless, plenty of good opportunities available for savvy and well-informed investors, ranging from new areas of investment to companies that are democratising access to products that had been unreachable for individuals. These investors are stepping ahead of the pack and deriving higher and more reliable returns.

"We are quite clearly living in fast-changing times," says Tim Corcoran, chief executive at Master Investor, the largest private investor show in Europe, which will take place in March 2020. "Investors may be concerned about uncertainty and volatility, but there are actually plenty of good opportunities and mitigation strategies available."

For some investors, a desire for better growth is focusing their attention on precious metals, where prices have been increasing. On the other hand, entirely fresh fields of investment are currently opening up and presenting additional huge opportunities.

"Cutting edge science is creating some amazing new possibilities," says Mr Corcoran. Among the most notable developments is the field of longevity, where researchers are making progress experimenting with ways of slowing, halting or even reversing the effects of ageing. "Any company making improvements to people's lifespans would be expected to derive substantial financial returns, so investors are beginning to really look into this area." At the event, the chief executives of longevity pioneers such as Juvenescence and AgeX Therapeutics will be speaking.

" Investors may be concerned about uncertainty and volatility, but there are actually plenty of good opportunities and mitigation strategies available

5,000
private investors

100
investment opportunities

55+
speakers across five stages

The Master Investor 2020 show will also be looking at the cannabis market, which is taking off rapidly in recreational and medical terms in North America, and growing across Europe with notable health and wellness applications. Equally, the show will have a focus on areas such as 'clean meat', whereby meat products are grown in laboratories rather than as livestock. Not only are these foods environmentally friendly but they are also suitable for vegans, whose buying habits represent a burgeoning consumer market.

There will also be a substantial focus on how to invest strategically to achieve long term growth. Executives from large funds such as BlackRock and the Scottish Mortgage Investment Trust will be speaking in sessions around such strategies, following highly positive feedback from their talks at last year's event. Meanwhile, respected entrepreneur and investor Jim Mellon will take to the main stage to share his latest thoughts on thematic investing and the key trends he sees having an impact over the coming years.

Attendees of the Master Investor 2020 event are expected to include investors ranging from those simply looking to grow their money more quickly now, to those looking to better shape their own retirement plans. Increased access to new retirement funds and the relatively low returns on offer through traditional investment vehicles are encouraging interest in emerging companies. In addition to those factors, new technology is becoming much more readily available to individual investors looking for access to new ways to boost their income and balance their portfolio of investments.

For private investors of all types, new technology opens up entirely new markets that would have been inaccessible even just a few years ago. Mr Corcoran gives the example of FinecoBank, whose head of brokerage will be speaking at the event. The company enables investors to buy shares in companies trading in different parts of the world, including on the Toronto Stock Exchange, where some of the world's biggest cannabis companies are currently trading.

"FinecoBank is an Italian company that has launched a trading platform that makes it incredibly easy for private investors to tap into foreign markets' stocks and shares," Mr Corcoran says. "To buy shares in a Canadian company, for example, is traditionally very difficult from outside, but that's no longer a problem and the resulting opportunities are clear to see."

Another important part of the picture for contemporary private investors is cutting edge platforms. These include NetWealth, which supports users in balancing their portfolios and making the right choices in line with their risk appetites. Meanwhile, UK-based WiseAlpha is enabling individuals to invest on a microscale in corporate and high-yield bonds, which until now had been solely the preserve of major investment funds. WiseAlpha will host the FintechWise stage at Master Investor 2020, with talks ranging from how technology is democratising financial services, to how pension providers are harnessing new systems to help people improve retirement planning.

Master Investor 2020, which takes place on 28 March at the Business Design Centre in London, will feature over 100 discussion opportunities and exhibitors from industry experts to a large number of listed and unlisted companies, funds and trusts. "Investors can engage with people from these companies and learn about future developments, opportunities and strategies," he says. "The show is a rare chance to deeply understand new areas of growth and meet the people making the difference."

Tickets for Master Investor 2020 are available now from masterinvestorshow-2020.reg.buzz and for a short time they are free to anyone using the code ST100WA

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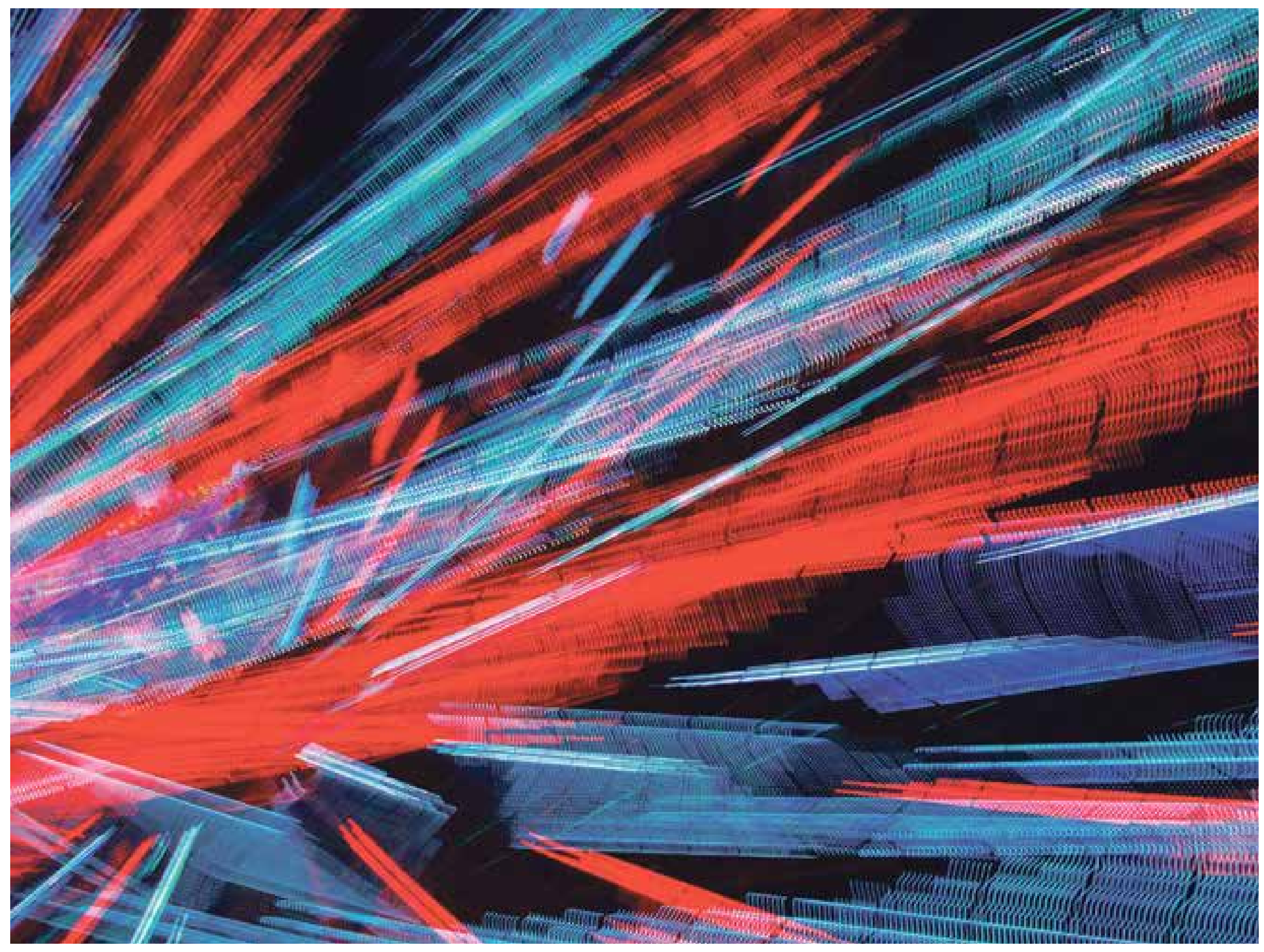
COCOS

Should the coco bond ban be lifted?

Deemed as unsuitable to the needs of ordinary retail investors, bank contingent convertible bonds may not be as risky as once thought

Nicola Tavendale



Contingent convertible bonds, or cocos, are bonds issued by banks and financial institutions that can be converted into equity in certain cirumstances, for example when a bank's regulatory capital falls below certain levels. Issuance has grown rapidly from 2014 as banks sought to meet higher Basel III capital requirements. They have been unavailable to ordinary UK retail investors since 2014, but many in the market argue the ban should now be lifted.

In October 2014, the UK's Financial Conduct Authority (FCA) introduced a set of intervention rules, which became permanent in 2015, that restricted the retail distribution of cocos to ordinary retail investors but gave certain exemptions to wealthier and more sophisticated investors.

In explaining the move, Christopher Woolard, then-FCA director of policy, risk and research, acknowledged investors might be tempted as cocos offered high headline returns in a low interest rate environment. "However, they are complex and can be highly risky. The FCA has used its new powers to ensure that cocos are not inappropriately made available to the mass retail market while still allowing access for experienced investors," he said.

> **"Their perceived riskiness is somewhat incongruous as cocos are arguably less risky than other securities**

The move was not without controversy and the FCA's market consultation prior to making the rules permanent attracted a range of opposing views to the restriction on ordinary retail investors. The FCA pointed out how little experience the market had of how cocos operate.

Yet five years on since the move, no Sterling coco has defaulted and financial institutions have a full decade of experience in using contingent convertible securities. According to Credit Suisse, since 2010 Sterling cocos have returned 11.6 per cent per annum and over the past 12 months 12.2 per cent. More striking is that over the same period UK bank equity has lost 2.6 per cent per annum and lost 9 per cent over the past 12 months according to the FTSE All-share Bank Index.

Rezaah Ahmad, founder of digital bond market WiseAlpha, says: "When you consider that retail investors are limited to investing in the listed equity of banks but are blocked by a combination of regulator policy and the corporate bond market from investing in lower risk bank debt or coco securities issued by the same company, you naturally end up with perverse consumer outcomes, antithetical to the aims of regulators."

Compared to the potential risks from other investments, such as equities, contracts for difference, peer-to-peer lending, equity crowdfunding or cryptocurrencies, is there now a case to revisit the restrictions placed on cocos and begin to open them up to individual investors?

Denise Yung, portfolio manager in Lombard Odier Investment Management's fixed income team, explains that because cocos are designed to absorb losses when an issuer's capital ratio falls below a certain level, to fulfil this purpose they have a combination of equity and debt-like features, which does make them riskier than other debt instruments.

"The FCA restricted the retail distribution of cocos due to the riskiness and complexity of the instruments. The intention of the rules is understandable given the numerous mis-selling scandals in recent years and the attractive yields offered by cocos in an environment of low interest rates," says Ms Yung.

"However, in our view, the perceived riskiness of the instruments is somewhat incongruous as cocos are arguably less risky than other securities that are available for retail distribution."

Although there have been no problems for UK issuers since the launch of cocos, in 2017 Spanish bank Banco Popular Espanol had its additional tier 1 cocos fully written down after the European Central Bank determined it to be "failing or likely to fail" and it was sold overnight to Santander. Banco Popular's equity and tier 2 debt, which ranked below and above its coco securities in the capital structure, was also wiped out, highlighting that while these are investments in highly regulated banks the risk of losing the entire investment remains.

Nevertheless, cocos have become a very popular financing tool and issuance has continued, mostly recently in emerging markets such as those in Asia-Pacific, with some $675-billion in cocos outstanding worldwide by 2017. Most cocos paid a coupon of between 6 and 9 per cent at the start of 2019, with yields continuing to attract institutional investors in the ongoing low interest rate environment.

According to a European Parliament briefing, cocos are also attractive to issuers because they help them satisfy regulatory capital requirements. In addition, equity is more expensive than debt in the sense that borrowers face less risk than shareholders.

However, Bjorn Norrman, investment manager in the fixed income team at Kames Capital, warns that while it is true equity investments are seemingly riskier, given they sit at the bottom of the creditor hierarchy, bank equity is still a cleaner and easier-to-understand investment.

"Investing in cocos requires intimate knowledge of bank and/or insurance capital regulation and, more specifically, under what scenario a bond may be converted to equity or coupons cancelled. Without this understanding it is problematic to assess the risks or establish likely returns," he explains.

"The high thresholds to investing in contingent capital are deliberate; regulators remain keen to protect direct investors from the allure of pure high coupons, not wanting that on their watch."

Among the many anomalies and unintended consequences created during the financial crisis was the issue of bank subordinated debt instruments that qualified as capital and were supposed to be loss absorbing, but often proved not to be, according to Mr Norrman.

What are cocos?

Contingent convertible bonds, or cocos, are a complex instrument that's a cross between bonds and a stock. They are widely seen as riskier investments than other debt instruments, designed to absorb losses when an issuer's capital ratio falls below a certain level as the securities are convertible into equity when a predefined "strike price" is triggered. They have been unavailable to ordinary UK retail investors since 2014.

In response, global regulators have sought to rectify this situation by clarifying and co-ordinating how subordinated debt instruments should function in times of stress and, in particular, under what circumstances contingent capital bonds should be activated.

"This is now embedded in underlying bond documentation, but the assessment of whether a bank has reached the point of non-viability is also subject to regulatory discretion," he says. "All in all this means that assessing the risk and complexity of contingent capital bonds can be nuanced."

Concerns around the complexity of the instruments are more well founded given the variety of features and the relative infancy of the asset class compared with equity and other debt instruments, Ms Yung agrees. To make the instruments more accessible to retail investors, it would help to see a stabilisation in banking regulations and a standardisation of contractual terms to create a more homogeneous asset class, she argues.

"Concerns could also be addressed by educating investors to increase their knowledge and by applying an appropriateness test to check investors' understanding of the instruments," Ms Yung concludes.

Rezaah Ahmad, founder of WiseAlpha, says perhaps there is also something to learn from the retail market review that the FCA has been conducting in the peer-to-peer lending space. Over the past five years the FCA abstained from placing any restrictions on retail investment in peer-to-peer lending while it observed, learnt and implemented rules for the industry.

The extended FCA review of the P2P market allowed a natural testing period to occur, forming the basis for the FCA to conclude that it would be suitable to introduce an appropriateness test for retail investors coupled with a limit for retail customers new to the sector of 10 per cent of investable assets.

Christopher Woolard, the FCA's executive director of strategy and competition, said the changes were about "enhancing protection for investors while allowing them to take up innovative investment opportunities. For P2P to continue to evolve sustainably, it is vital that investors receive the right level of protection."

Would a similar approach towards the coco market help create the industry conditions necessary for mainstream retail market participation?

RISE OF THE COCOS

Cumulative issuance; additional tier 1 bonds sold by European banks (€bn)