Factors That Affect Prices of Fixed Income Securities

As an integral part of a well-balanced and diversified portfolio, fixed income securities afford opportunities for predictable cash flows to match investors' individual needs, provide capital preservation and may offset the volatility of the stock market. However, all investments have some degree of risk. In general, the higher the return potential, the higher the risk. Safer investments usually offer relatively lower returns.

While the interest payment or coupon on most bonds is fixed and the principal amount, known as par value, is returned to the investor upon maturity, the market price of a bond during its life varies as market conditions change. Consequently, if a bond is sold prior to maturity, the proceeds may be more or less than the original purchase price or the quoted yield. If a bond is held to maturity, an investor can expect to receive the return or yield at which the bond was initially purchased, subject to credit worthiness of the issuer.

There are a number of variables to consider when investing in bonds as they may affect the value of the investment. These variables include changes in interest rates, income payments, bond maturity, redemption features, credit quality and priority in the capital structure, price, yield, tax status and other provisions that are covered in the offering documents.

In general, investors demand higher yields to compensate for higher risks. Discussed below are some of the most common risks associated with fixed income securities.

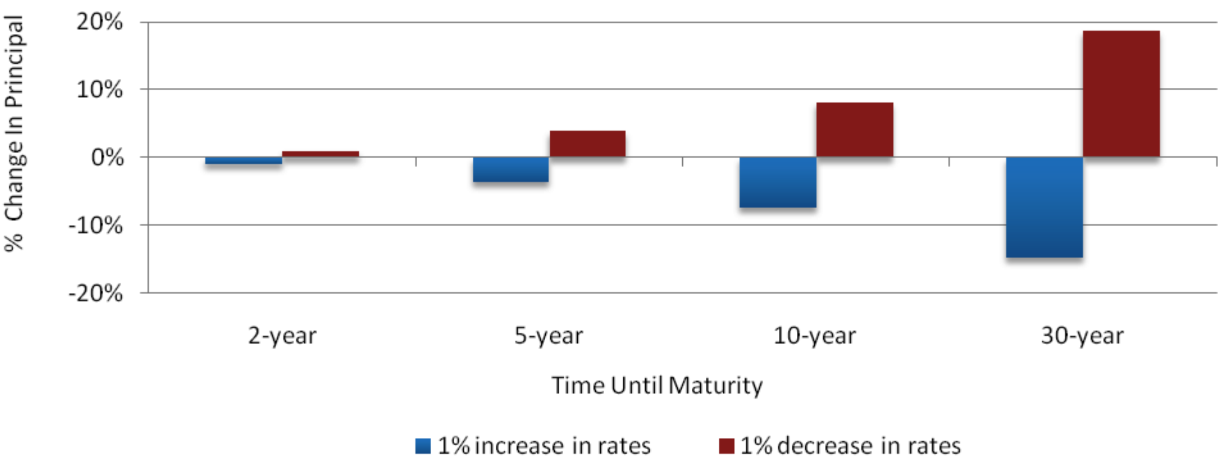
Interest Rate Risk

The market value of the securities will be inversely affected by movements in interest rates. When rates rise, market prices of existing debt securities fall as these securities become less attractive to investors when compared to higher coupon new issues. As prices decline, bonds become cheaper so the overall return, when taking into account the discount, can compete with newly issued bonds at higher yields. When interest rates fall, market prices on existing fixed income securities tend to rise because these bonds become more attractive when compared to the newly issued bonds priced at lower rates.

Price Risk

Investors who need access to their principal prior to maturity have to rely on the secondary market to sell their securities. The price received may be more or less than the original purchase price and may depend, in general, on the level of interest rates, time to term, credit quality of the issuer and liquidity. Among other reasons, prices may also be affected by current market conditions, or by the size of the trade (prices may be different for 10 bonds versus 1,000 bonds), etc. It is important to note that selling a security prior to maturity may affect actual yield received which may be different than the yield at which the bond was originally purchased. This is because the initially quoted yield assumed holding the bond to term.

As mentioned above, there is an inverse relationship between interest rates and bond prices. Therefore, when interest rates decline, bond prices increase, and when interest rates increase, bond prices decline. Generally, longer maturity bonds will be more sensitive to interest rate changes. Dollar for dollar, a long-term bond should go up or down in value more than a short-term bond for the same change in yield.



Liquidity Risk

Liquidity risk is the risk that an investor will be unable to sell securities due to a lack of demand from potential buyers, sell them at a substantial loss and/or incur substantial transaction costs in the sale process. Broker-dealers, although not obligated to do so, may provide secondary markets.

Reinvestment Risk

Downward trends in interest rates also create reinvestment risk, or the risk that the income and/or principal repayments will have to be invested at lower rates. Reinvestment risk is an important consideration for investors in callable securities. Some bonds may be issued with a call feature which allows the issuer to call, or repay, bonds prior to maturity. This generally happens if the market rates fall low enough for the issuer to save money by repaying existing higher coupon bonds and issuing new ones at lower rates. Investors will stop receiving the coupon payments if the bonds are called. Generally, callable fixed income securities will not appreciate in value as much as comparable non-callable securities.

Prepayment Risk

Similar to call risk, prepayment risk is the risk that the issuer may repay bonds prior to maturity. This type of risk is generally associated with mortgage-backed securities. Homeowners tend to prepay their mortgages at times that are advantageous to their needs, which may be in conflict with the holders of the mortgage-backed securities. If the bonds are repaid early, investors face the risk of reinvesting at lower rates.

Purchasing Power Risk

Fixed income investors often focus on the real rate of return, or the actual return minus the rate of inflation. Rising inflation has a negative impact on real rates of return because inflation reduces the purchasing power of the investment income and principal.

Credit Risk

The safety of the fixed income investor's principal depends on the issuer's credit quality and ability to meet its financial obligations, such as payment of coupon and repayment of principal at maturity. Rating agencies assign ratings based on their analysis of the issuer's financial condition, economic and debt characteristics, and specific revenue sources securing the bond. Issuers with lower credit ratings usually have to offer investors higher yields to compensate for additional credit risk. A change in either the issuer's credit rating or the market's perception of the issuer's business prospects will affect the value of its outstanding securities. Ratings are not a recommendation to buy, sell or hold and may be subject to review, revision, suspension or reduction, or may be withdrawn at any time. If a bond is insured, attention

should be given to the credit worthiness of the underlying issuer or obligor on the bond as the insurance feature may not represent additional value in the marketplace or may not contribute to the safety of principal and interest payments.

Bond Credit Quality Ratings Rating Agencies				
		Moody's*	Standard & Poor's**	Fitch Ratings**
Investment Grade	Strongest	Aaa	AAA	AAA
		Aa	AA	AA
		A	A	A
		Baa	BBB	BBB
Non-Investment Grade	Weakest	Ba	BB	BB
		B	B	B
		Caa	CCC	CCC
		Ca	CC	CC
		C	D	C
		C	D	D

Source: SIFMA's www.investinginbonds.com

* The ratings from Aa to Ca by Moody's may be modified by the addition of a 1, 2 or 3 to show relative standing within the category.
** The ratings from AA to CC by Standard & Poor's and Fitch Ratings may be modified by the addition of a plus or minus sign to show relative standing within the category.

Capital Structure

It is important to know and understand how fixed income securities are ranked in the capital structure of the issuer. The ranking of a fixed income security is yet another factor that may affect its price. It determines the order of repayment priority by the issuer. Most bonds are unsecured debentures or promises to pay and do not have assets pledged to support the bond payments. They can be ranked senior, subordinated, or lower in the capital structure. Preferred securities are typically ranked below corporate bonds in repayment priority.

Senior Secured Debt
May include: Baby Bonds, Exchange Traded Debt
Senior Unsecured Debt
May include: Baby Bonds, Exchange Traded Debt
Senior Subordinated Debt
May include: Baby Bonds, Exchange Traded Debt
Junior Subordinated Debt
May include: Trust Preferreds
Junior, Junior Subordinated Debt
May include: Newer Hybrid Capital
Preferred Shares
May include: Traditional, DRDs, REITs, ADRs, ADS
Common Shares

Default Risk

The risk of default is the risk that the issuer will not be able to make interest payments and/or return the principal at maturity.

Professional advice and, in many cases, professional management, are key elements of successful financial planning. Bonds, by their very nature, provide investors with an opportunity to initiate investment strategies that complement individual objectives. Those who wish to optimize the bond market opportunities created by movements in interest rates may wish to seek professional management. On the other hand, investors who want to create a sound portfolio foundation based on predictable returns and reduced risk may choose to implement fixed income investment strategies that suit their individual needs and risk tolerance.

Raymond James Financial Advisors assist investors in creating well-diversified* fixed income portfolios designed to perform well in unpredictable market environments. The objective of these portfolios is to attempt to preserve investors' capital and minimize risks while maximizing returns. To learn more about taxable bonds and fixed income services offered by Raymond James, please contact your Financial Advisor.

More information is available from Industry organizations such as www.investinginbonds.com and www.finra.org.

*Diversification does not guarantee a profit and does not protect against a loss.

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