

FIXED INCOME SECURITIES

Standard description: A contractual obligation for the repayment of loaned funds.

September 1999

September 1990

Holdings of Bonds (in billions)

Asset

Institution	Corp. Bonds	US Gov't.	Tax Exempt	Mortgages
Commercial Banks	86.8	402.2	133.8	763.5
Mutual Savings	11.5	36.5	1.7	168.5
S&L's	48.8	197.9	1.0	748.2
Life Insurance	520.4	151.8	9.2	245.3
Private Pensions	144.4	142.8	0	6.6
State and Local Pensions	198.9	198.2	0.5	15.2
Households	117.2	927.8	348.5	0
Other	221.2	1,238.2	97.0	1,586.8
Mutual Funds	74.1	120.0	93.6	0
Other Insurance	79.3	97.0	135.9	6.0
TOTAL	1,502.6	3,512.4	821.2	3,540.1

Major characteristics

- 1. Coupon.** In the simplest case the coupon is known and fixed. But there are numerous exceptions. GNMA is an example.
- 2. Maturity.** Again can be fixed or there can be discretion.
- 3. Default risk.** Chance that promised payments are not met.
- 4. Options.**
 - a. call**
 - b. sinking**
 - c. prepayment**
 - d. convertible**
- 5. Tax treatment**
 - a. exempt**
 - b. preferential**

Major categories

U.S. Government

Types:

- A. Bills** **Maturity less than one year
pure discount**
- B. Notes** **1-10 years at issuance twice a
year**
- C. Bonds** **Greater than 10 at issuance;
some were callable**

Characteristics:

- 1. Highly liquid**
- 2. Taxed at Federal, not State or Local**
- 3. Mostly non-callable**

Corporate

Characteristics:

- 1. Both publicly and privately placed**
- 2. Fully taxed**
- 3. Varying liquidity**
- 4. Varying default risk**
- 5. Often options**

Mortgage Backed

Mortgages are pooled and a security is issued against the pool.

Characteristics:

- 1. Government guarantees and issuer guarantees**
- 2. Guarantees and administrative cost are a fee and reduce interest received**
- 3. Homeowner has the option of prepayment**

Municipal

Issuances of state or local government or authority of government

Characteristics:

- 1. General obligations or revenue bonds**
- 2. Default risk**
- 3. Tax exempt in state of issuance against state tax**
- 4. Exempt for federal tax**
- 5. Varying liquidity, usually illiquid**

Eurobond

Define: Unregistered bond

- 1. Annual interest**
- 2. Some bonds pay in multiple currencies (interest one currency principal another) or have options as to which currency the investor receives cash flows from.**
- 3. Often have warrants**

LIBOR

London Interbank Offered Rate

- **rate at which London banks lend money to each other**
- **normally is about the Treasury bill rate plus 50 bp**

Major Objectives of Purchasers

1. Risk return profile

a. Mutual funds

b. Many individuals

2. Meeting stream of liabilities

a. Fixed and known

(1) GIC

(2) Pension of retired

b. Stochastic and independent of bond returns

(1) Active employees pension

c. Stochastic and dependent

(1) casualty insurance

Securitization

Examples:

- 1. GNMA**
- 2. Strips**
- 3. Cars**
- 4. CMO**

Main Reasons:

- 1. Improve asset liability mix of holder**
- 2. Provide new cash flow patterns**
- 3. Provide instruments with a different response pattern to changes in economic conditions**