



Fixed Income Made Simple: Essential Terms and Definitions

Many investors will have some exposure in their investment portfolio to bonds. Bonds can be an important component in an overall asset allocation as they typically (1) provide a reliable income stream and (2) preserve capital. While on the surface the mechanics of bond investments can seem straightforward (a loan in which the issuer agrees to pay the buyer interest for the loan), there are many terms that are used to describe the basic components of a bond that can be confusing.

By using the below illustration, we will outline and define the main terms used to describe the primary components of a bond investment. The collection of terms and definitions are the primary ones that will be seen on statements, bond offerings, trade confirmations, and heard in the news.

Name of Bond	Any City CA Unified School District General Obligation
Coupon	5.00%
Maturity	07/01/2033
Callable	01/01/2028
Rated	Aa3 / NR
Purchase Date	10/26/23
	100,000 Par Value Purchased at a 3.924% Yield to Call; 4.473% Yield to Maturity
Purchase Price	\$104.104
Accrued Income	\$1,652.78
Total	\$105,748.78
CUSIP	123456AA9

Term	Example	Definition
Issuer	Any City CA Unified School District	The investor is loaning the school district the par value of the bond until either the Call date (January 1st, 2028) or until maturity (Jul 1st, 2033).
Revenue Source	General Obligation	In this example, an additional tax within the Any City CA Unified School District boundaries that funds repayment of the bonds (for further discussion of revenue sources, see our paper: Muni Bond Basics).
Coupon	5.00%	The bond will pay a 5.00% interest rate until maturity on a semi-annual basis. In this example, it would pay \$2,500 on both January and July 1st (the maturity day and month, and 6 months later).
Maturity	07/01/2033	On this date, the bond will pay/return its par value (\$100,000) and the final coupon payment (\$2,500).
Call Date	01/01/2028	On the call date, the Issuer has the right to pay off the bond early. Unlike your home mortgage, a municipality cannot refinance at any time. They can only pay off debt early on the stated Call Date. Were the bond to be called, the investor would receive the par value (\$100,000) and the now final coupon payment (\$2,500).
Ratings	Aa3 / NR	Bonds are rated by several agencies. The standard reported ratings are Moody's and S&P. In this example, Moody's has rated the bond Aa3 (Aaa is the highest on their scale, followed by Aa1, Aa2, Aa3, A1, A2, A3, Baa1... etc.) The issuer did not pay S&P to also rate the bond, relying on just one firm's ratings. This does not diminish the rating of the bond.
Par Value	\$100,000	The number of bonds held. This is the amount that will be paid upon maturity of the bonds. In this example, the par value is \$100,000.
Duration	3.95 years	This is a measure of time and volatility. The higher the number, the longer the time until the expected maturity or call, and the more volatile the market value of the bond will be with changes in interest rates.
Accrued Income	\$416.67	Bonds pay interest semi-annually. When an investor buys a bond on a date between those payments, she pays the current holder of the bond the amount of interest that has been earned for the days that they held the bond. When the coupon comes on the payment date, the new holder receives the full coupon payment. In this way, the original holder of the bond is paid back their initial principal, plus the income that they have earned by holding the bond.
CUSIP	123456AA9	This 9-digit number is a unique code that allows investors to identify a specific bond.
Dollar Price	\$104.104	The dollar price of the bond is determined by the yield at the time of pricing, the coupon and the maturity and call dates. If the yield is higher than the coupon, the bond it is said to be at a discount. Conversely, if the yield is lower than the coupon, the bond is said to be at a premium. In this example, the bond's coupon is 5.00% and the yield is 3.924%, thus making this a premium bond.

Yields: Many different yield numbers are referenced in fixed income. All are important and measure expected return in different ways.

Term	Example	Definition
Yield to Maturity	4.473%	This is the most quoted yield figure. It is trying to calculate the amount of income an investor will earn on an annualized basis if they hold the bond to maturity and are paid all of the coupon payments and the final par value at maturity. It also assumes that all the income from the coupon payments is reinvested at the same interest rate as the initial investment (which is not always possible).
Yield to Call	3.924%	This calculation is similar to the calculation for Yield to Maturity with the exception that it is calculating to the first call date.
Current Yield	4.80%	This number is for comparing the cash yield, as opposed to the yields to maturity and call. This yield is based on today, not a future time calculation. It is simply dividing the income the investor will earn this year by the current market value. What am I earning this year on my current investment? In our example: $\$5,000 / \$104,104 = 4.80\%$.

Important Terms Outside of this Example:

Term	Definition
Interest Rate	This is the cost of borrowing. It is the rate that the person or entity borrowing money will need to pay the lender on an annual basis to have the use of the lender's funds. We typically see this referred to when the Federal Reserve changes short-term interest rate levels, for home mortgages, car loans, or in reference to any debt instrument.
Interest Rate (Yield) Curve	This is a series of interest rates for different time periods, typically for U.S. Treasury Notes. A borrower needs to pay a different amount in any economic environment to borrow money for 3 months versus what she would for 5 or 10 years. It is constructed by adding the interest rate for every period from the 3-month U.S. Treasury to the 30-year U.S. Treasury. The shape that these points make on a graph is referred to as the yield curve and provide capital market participants a great deal of information.

There are a wealth of considerations involved in analyzing and deliberating fixed income investment strategies, and building a proper portfolio to meet an investors goals, that go far beyond the terms discussed above. **Contact our experienced team** to discuss your investment objectives and explore how fixed income investing aligns with your financial goals.

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