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BONDS: AN ALTERNATIVE INVESTMENT AVENUE

1. What Are Bonds?

A bond is a type of debt instrument through which an investor lends money to a government or a company for a specified period. In return, the issuer may pay interest at a predetermined rate and repay the principal according to the bond's terms.

In simple words, when you invest in a bond, you are lending money to the issuer and earning interest in return.

For example, suppose you invest ₹1,00,000 in a bond offering an annual coupon rate of 9%. If the bond pays interest annually, you may receive ₹9,000 in annual interest, subject to the bond's terms. The principal is generally repayable at maturity, provided the issuer meets its obligations.

2. Types of Bonds

Government Bonds: Issued by the Central or State Government to raise funds. Government securities are generally considered to have very low credit risk when issued by the Central Government, although their market prices can fluctuate.

Corporate Bonds: Issued by companies to raise capital for business expansion, operations, or other financial requirements. Their interest rates and risks vary depending on the issuer and the bond's features.

Secured Bonds: Backed by specified assets or collateral. However, security does not guarantee repayment; recovery depends on the terms, enforceability of the security, and the issuer's financial position.

Unsecured Bonds: Not backed by specific collateral. Investors depend primarily on the issuer's ability to meet its repayment obligations.

Bonds may also differ in their interest payment frequency, maturity period, credit rating, and redemption terms.

3. Why Consider Investing in Bonds?

A. Regular Income Potential

Many bonds pay interest monthly, quarterly, half-yearly, or annually. This can help investors plan for periodic cash flows, depending on the bond's payment schedule.

B. Potentially Attractive Returns

Certain corporate bonds offer higher coupon rates than traditional fixed deposits. However, a higher return generally comes with higher credit, liquidity, or other risks. The coupon rate should not be confused with the actual yield or guaranteed return.

C. Portfolio Diversification

Bonds can complement equity mutual funds and shares in a diversified portfolio. Their behaviour may differ from equities, although bond prices can also fluctuate with interest rates and market conditions.

D. Defined Investment Horizon

Bonds have specified maturity dates or redemption terms. Investors who align the maturity period with their financial goals may find this useful for planning.

E. Choice of Risk and Return

Investors can explore bonds with different credit ratings, maturities, interest rates, and security structures according to their financial goals and risk tolerance.

4. How Can You Invest in Bonds?

Investors can generally access bonds through two routes:

Primary Market: Investing when a bond is newly issued and offered to investors.

Secondary Market: Purchasing an existing bond from another investor through an eligible trading platform or broker. The price may be above or below its face value, depending on market conditions.

A practical investment process involves the following steps:

1. **Complete KYC:** Ensure your identity and address verification are up to date.
2. **Arrange a Demat Account:** A demat account is generally required to hold listed bonds electronically. The precise requirements depend on the investment route and instrument.
3. **Select a Suitable Bond:** Compare the issuer, credit rating, coupon rate, yield, maturity date, security, and payment frequency.
4. **Review the Terms:** Read the offer document or relevant disclosures, including redemption provisions, default risks, and any early-exit restrictions.
5. **Transfer Funds:** Make the payment through the prescribed banking and settlement process.

6. **Receive the Investment:** Once the transaction is completed and settled, the bond is credited to your demat account, where applicable.
7. **Track Interest and Maturity:** Monitor interest payments, issuer updates, and the repayment schedule.

5. What Is Required to Invest?

Investors will typically need:

- **PAN Card:** For identification and financial transactions.
- **KYC-Compliant Documents:** Such as identity and address proof, as applicable.
- **Bank Account:** For making payments and receiving interest and redemption proceeds.
- **Demat and Trading Account:** Generally required for listed bonds purchased through the exchange route.
- **Investment Amount:** The minimum amount depends on the particular bond and its issue terms.
- **Risk Assessment:** An understanding of the investment horizon, liquidity needs, and ability to bear potential losses.

The exact requirements may vary according to the bond and the method of purchase.

6. What Should You Check Before Investing?

Before investing, consider these important factors:

- **Credit Rating:** Ratings from recognised agencies help assess credit risk but do not guarantee repayment.
- **Yield to Maturity (YTM):** An estimate of the annualised return if the bond is held until maturity and the relevant assumptions hold. It is not a guaranteed return.
- **Maturity Period:** Ensure the investment horizon matches your financial requirements.
- **Liquidity:** Some bonds may be difficult to sell quickly at a fair price. Early exit may result in a loss.
- **Security and Default Risk:** Check whether the bond is secured, the nature of its collateral, and the issuer's capacity to repay.
- **Taxation:** Interest income and capital gains may have different tax implications depending on the instrument and applicable rules.

7. Are Bonds Suitable for Everyone?

Bonds may suit investors seeking periodic income, diversification, or investments with a defined maturity. However, they are not risk-free. Issuers may default, market interest rates may affect bond prices, and selling before maturity may lead to losses.

Investors should select bonds based on their financial goals, liquidity requirements, and risk appetite rather than choosing solely on the basis of the highest advertised interest rate.

The Way Forward

Bonds can be a valuable component of a well-diversified investment portfolio when selected carefully. Understanding the issuer, credit quality, yield, maturity, and liquidity is essential before investing.

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* Mutual funds are subject to market risks. Please read all scheme-related documents carefully before investing. Past performance does not indicate future results. Investments are subject to market fluctuations, and there is no assurance of returns.