



What is a government bond, simple?

A bond is a financial instrument and in principle a loan to the issuer of the bond. In return for the loan, the issuer pays interest to the investor. Government bonds are issued by sovereign states or state guaranteed undertakings such as a credit institution for a local or regional authority. Bonds issued by economically stable sovereign states are generally very safe investments since the probability of default is at a minimum. Countries with unstable economies, political situations, etc.

will basically have a lower credit rating, and therefore government bonds from these countries will entail a higher risk.

For which investors are government bonds relevant?

Government bonds are relevant for investors wanting a relatively reliable investment with a relatively safe and stable return.

Pros and cons

GOVERNMENT BONDS

Pros

- It is possible to obtain a relatively safe and stable return.
- You will receive interest on an ongoing basis.
- Government bonds are generally liquid and there is often a well-functioning market with prices quoted daily.

Cons

- The return is typically lower than the return on equities.

What happens in practice?

To buy bonds you must have the full purchase amount at your disposal in your account. After the purchase, you will regularly receive interest on the bond. The price of the bond is determined by supply and demand and by investors' expectations of the issuing state.

Return

Bonds are generally a relatively safe investment. The total return depends on both the price and the coupon (interest) on your bonds. If you purchased a bond with a fixed coupon, you can expect fixed coupon payments. The price may vary over time and may influence your total return if you sell the bond before maturity. Most government bonds have a fixed coupon.

About risk

Several risk factors must be considered when investing in government bonds.

A government bond may become worthless if the issuing state defaults.

The price may change if there is a change in the creditworthiness of the issuer of your bond, which for most bonds is expressed through a rating. A poor rating typically means a higher risk of default. Ratings are issued by rating agencies such as Moody's, S&P and Fitch, and they have different scales ranging from the best to the poorest rating. You should therefore consider the rating of the bond. Typically, there is a correlation between the credit rating of the issuer and the risk/reward. The lower the credit rating, the higher the risk and the higher the reward.



Prices on your bonds fluctuate in step with changes in the interest rate level. This applies in particular to fixed rate bonds with a long time to maturity: the price on such bonds will rise when the interest rate falls, and the price will fall when the interest rate rises.

Moreover, liquidity in bonds varies quite a lot. Basically government bonds are liquid, but there may also be bond series that are not liquid. Some of the parameters that affect liquidity of a bond series are: the size and creditworthiness of the issue, demand, the question whether the bond is traded in a regulated market (for instance, OMX), the interest rate level, uncertainty in the market, unstable prices.

If you buy a bond denominated in another currency (for instance, euro) than your base currency (for instance, the British Pound), you assume an exchange rate risk.

When using benchmarks (e.g. interest rate benchmarks) in government bonds, you must be aware of the risk that these benchmarks are or can be subject to national, international or other initiatives, which may mean that the composition of the benchmark is changed or that the benchmark completely disappears.

Further information is available at:
trustednovusbank.gi/general-terms/fallback-plans

According to the risk classification, government bonds issued in Danish kroner and euro by euro zone countries with gross debts of less than 110 per cent of the country's GDP are categorised as green whereas other government bonds are amber.

Read more about the risk classification of investment products at:
trustednovusbank.gi/investmentinformation

Tax

We do not give advice on tax issues in connection with specific transactions. If you wish to learn about the specific importance of the tax rules for you, we recommend that you consult your accountant.

What you should know before trading

We recommend that your investment profile is reviewed before you engage in transactions. Your relationship manager can help you with that. We also recommend that you contact your relationship manager if you have any questions in relation to anything described in this fact sheet, or if you would like to have some points clarified.