



The typical objective of a bond fund is to provide a stable income stream with minimal capital risk by investing in debt securities. Government and corporate bonds are the two major types of debt securities in which a bond fund usually invests to enjoy the coupon income and capital gain potential for retail investors. In the following paragraphs, brief insights on the difference between the two debt securities will be covered.

Government Bonds


- Governments issue bonds to support country development projects and pay off the national debt. Sometimes, agencies, which are government-related entities that are either fully or majority owned by the government issue bonds as well. For instance, the Hong Kong Mortgage Corporation Limited is classified as agency as it is wholly owned by the Hong Kong government through the Exchange Fund. Supranational organizations like the World Bank and the Asian Development Bank also issue bonds to raise funds internationally to finance projects in developing nations.
- In recent years, government bonds issued by emerging market governments have become increasingly popular. Geographically speaking, emerging markets refer to governments or economies in less mature markets e.g. Eastern Europe, Latin America, and developing Asia. The credit ratings of issuers in emerging markets are relatively lower, which imply higher yields to compensate additional risk taken by investors.

Corporate Bonds

- Corporate bonds are bonds issued by corporates in private sector to raise capital for business development or refinancing. They are typically structured in a similar way to government bonds. That is, they pay fixed coupons and have a fixed redemption date. The concepts of yield and duration are applicable to both corporate bonds and government bonds.
- Compared to equity, corporate bonds are regarded as a safer asset class, in the sense that bonds have a liquidation priority over all equity, and the bond issuers will make coupon and capital payments due on their bonds on time. However, we should note that corporate bonds are not 'risk free'. The spreads between corporate bond yields and yield of risk free bonds (typically the US Treasuries) reflect the market expected risk for the corporate bonds. In other words, the wider the spreads, the cheaper the corporate bonds but at a higher expected risk levels.

Government bonds issued by developed countries such as the United States are generally accepted to be 'safer' as governments are less likely to default. Second, the corporate bond market is structured as a 'dealer market', in which various dealers in corporate bonds post buying and selling prices. This contrasts with most government bond markets around the world, where a set of primary dealers, in return for various commitments to maintain liquid market conditions, are granted access to new government bond issues.

Direct access to the bond market may not be as friendly as stockmarkets for many retail investors, in respect of the larger initial investment amount and the 'dealer market' trading practice. As such, exposure to bonds is typically better achieved for retail investors by investing in a bond fund for both government and corporate bonds.

 (852) 3191 8282

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