1. **Dual nature of high yield bonds**

High yield bonds have dual share-bond characteristics.

As a bond or debt, their value is closely linked to the issuer’s creditworthiness, i.e. its ability to honour its commitments and to perform. The market also assesses this capacity through price of shares in the issuer. High yield bonds not only depend on bond markets, but also on company risk, reflected in stock markets.

High yield bond investors must therefore:

- **Be alert** to any event likely to affect the issuer’s trading and creditworthiness

- **Verify that a bond’s spread matches the issuer’s creditworthiness.** When they consider that the spread underestimates the creditworthiness, they subscribe to the issue. Conversely, when the spread is insufficient, they reduce holdings in the bond

- **Diversify their portfolios** between sectors and companies, as is the practice of all share investors

2. **High yield bonds and volatility**

Another characteristic of high yield bonds is their volatility.

High yield bonds are more volatile than government bonds. At constant spread, high yield bonds are less susceptible to rises in long-term interest rates than government bonds, due to their higher interest rates. But high yield bonds are much more affected by the issuer's creditworthiness, which is considerably more uncertain than that of a country. The impact of creditworthiness on high yield bonds’ values and interest rates is in fact decisive.

**Yet high yield bonds are, in theory, less volatile than shares, as they are less risky.** In the event of liquidation, creditors are in fact reimbursed before the shareholders, so corporate bonds can still be worth something when shares are already worthless.
3. High yield bonds and liquidity

Another characteristic of high yield bonds is liquidity. A company’s listed debt often comprises several tranches exhibiting distinct characteristics, each with a much smaller capitalisation than that of equity. During stock market turmoil, the lack of liquidity produces distortions between a bond’s spread and intrinsic risk. These distortions offer as many opportunities to buy as to sell.

This is the third in a four-part series.