CORPORATE BONDS

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ADVISORS ASSET MANAGEMENT

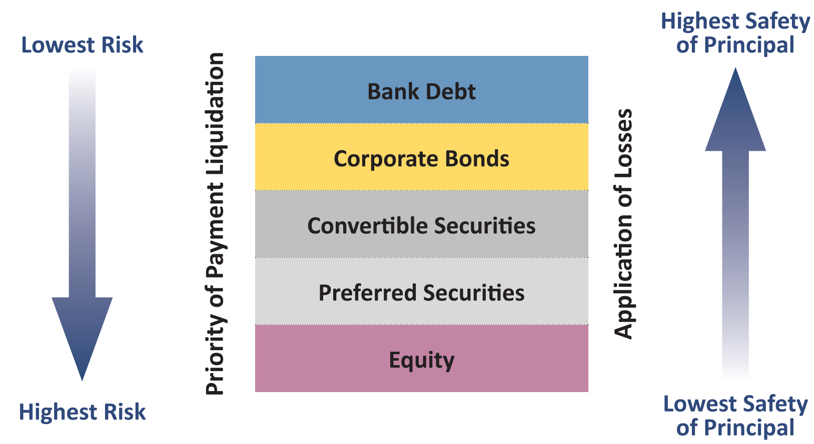
Fixed income market insights from Advisors Asset Management, Inc.

Corporate bonds are debt obligations issued by corporations to fund capital improvements, expansions, debt refinancing, or acquisitions. The size and scope of the overall market for corporate bonds is robust. Investors in corporate bonds have a wide range of choices when it comes to bond structures, coupon rates, maturity dates, credit quality, and industry exposure.

Unlike equities, ownership of corporate bonds does not signify an ownership interest in the company that has issued the bond. Instead, the company pays the investor a rate of interest over a period of time and repays the principal at the maturity date established at the time of the bond's issue. An owner of a corporate bond is a lender to the company who issued the debt.

Debt instruments of corporations rank in seniority in terms of the company's capital structure. Most corporate bonds that are widely traded are unsecured (either senior or subordinated). In the case of a corporate default, the table below illustrates which order any claims would be paid.

Corporate Capital Structure



Main Types of Corporate Bonds

The various types of corporate bonds offer different risk levels, as well as varying yields and payment schedules.

- **Fixed vs. Floating Rate**
  Two of the most common types of bonds are fixed rate bonds and floating rate notes. Fixed rate corporate bonds are typically structured to pay out regular coupons until maturity, at which time the par value is also paid back to the investor. Conversely, floating rate notes are generally indexed to a floating interest rate, set one period at a time, at the beginning of each coupon period or other variable rate structures.

- **Investment Grade vs. Non-Investment Grade (High Yield)**
  Corporate bonds are categorized either as investment-grade or non-investment grade. Non-investment grade bonds are also called high-yield bonds, or "junk bonds". When a company's debt is rated BB+ or below by S&P or the equivalent by another ratings agency, the bonds would be considered "high-yield".

Reasons to Consider Corporates:

- **Diversification and Range of Choices**
- **Predictable Income**
- **Marketability**

Advisors Asset Management, Inc.

Deeply rooted in the fixed income markets since 1979, Advisors Asset Management, Inc. (AAM) has provided financial professionals with comprehensive access to the bond market in conjunction with simple and efficient trading support. Our long-standing relationships and Capital Markets expertise allows establishment and maintenance of an attractive inventory of securities, offering advisors the opportunity to capitalize on pricing, yields, and quality issues.

AAM's seasoned fixed income trading team is comprised of more than 20 professionals, who average over 16 years of industry experience. Our open-architecture offering system provides advisors access to all major ECNs, as well as our own inventory. For almost 40 years, AAM has been a trusted resource for financial advisors and broker/dealers. In addition to the fixed income markets, AAM offers access to structured products, unit investment trusts (UITs), mutual funds, managed accounts, and ETFs.

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While high-yield bonds generally do pay considerably higher yields than U.S. Treasuries and investment-grade corporates, they also contain a higher amount of credit risk. Volatility and price fluctuations tend to be more pronounced in high-yield or "junk" bonds as the market for them is much smaller and fewer large institutions make markets in these securities.

- **Zero-Coupon**
  Some corporate debt can be zero-coupons that the investor purchases at a discount to face value and receives back at face value – the bond's only cash flow being the payment at maturity. The difference between the purchase price and the face value represents the interest earnings on the bond.

- **Callable**
  Bonds can contain call provisions that allow the company to repay the debt before maturity at par value or par value plus an additional amount. Call provisions benefit the issuer and such provisions may require the issuer to pay extra yield to compensate investors for the inclusion of this issuer benefit.

- **Convertible Bonds**
  Some bonds include "convertible" features which permit the bondholder, under certain conditions, to convert bonds into equity according to a conversion ratio specified in the bond indenture. Convertible bonds are sometimes simply called "convertibles". Convertibility features benefit the investor and generally permit the issuer to pay less yield on the bond via inclusion of this benefit in the contract.

Features and Benefits

- **Credit Quality/Ratings:** Credit rating agencies play a critical role in helping the investment community gauge the riskiness of corporate bonds. Ratings from these agencies provide an immediate sense of the credit and re-payment risk associated with a bond issuance. The two largest credit ratings agencies that assign credit (default) ratings to bonds include Standard & Poor's (S&P) and Moody's Investors Service.

  Generally, the higher the rating an issuer's bonds are as signed, the lower probability of default by said issuer as determined by the rating agency. Ratings for a particular bond issuer may change over time as circumstances with each issuer change. The following table shows the credit ratings for S&P and Moody's from highest to lowest.

Credit Ratings Table

S&P	Moody's	Description
Investment Grade		
AAA	Aaa	*Prime*
AA	Aa	*High Grade*
A	A	
BBB	Baa	*Lower Medium Grade*
Non-Investment Grade (High Yield)		
BB	Ba	*Non-Investment Grade*
B	B	*Highly Speculative*
CCC	Caa	
CC	Ca	*Substantial Risk; Default Imminent*
C	C	
D	/	*In Default*

- **Higher Yields than Treasuries:** U.S. corporate bonds generally provide higher yields than U.S. Treasuries providing investors with the opportunity to earn more interest income. The increased yield typically comes at the cost of increased credit risk and other risks associated with corporate securities, therefore, investors should carefully consider whether the yield is properly balanced against the risk.

- **Predictable Income:** Corporate bonds typically pay semi-annual coupons until maturity, then the par value at maturity. The predictable schedule of payments helps investors build regular income streams into their investment portfolio.

- **Diversification:** The sheer range of corporate bonds available to investors differentiated by industry, bond structure, collateralization, maturities, yields, and other features described earlier, provides investors with a great array of possibilities for constructing a diversified fixed-income portfolio.

  While some corporate bonds have redemption or call features which can affect the maturity date, most are loosely categorized into the following maturity ranges:

  — *Short-Term Notes* (0 to 5 years)
  — *Medium-Term Notes* (5 to 12 years)
  — *Long-Term Bonds* (greater than 12 years)

- **Marketability:** Corporate bonds are traded in the secondary market. Generally, high quality issuances from large companies are most liquid and can be sold through a bank or broker before a bond's maturity. This liquidity provides an investor additional flexibility in managing a portfolio of investments. Certain corporate bonds could be less liquid than others.

Buying and Selling Corporate Bonds

Generally, corporate bonds are traded OTC (Over The Counter) between dealers. Dealers usually consummate trades via the telephone or electronic trading platforms.

Because some issues can be "thinly traded" if they are small in size or only a few dealers may be providing secondary markets, information about pricing can be hard to obtain. To help investors, FINRA (Financial Industry Regulatory Authority) has made available data from trades occurring in the market on their website using the TRACE reporting facility. See http://finra-markets.morningstar.com/MarketData/Default.jsp for more information.

Potential Risks

Investors should be well aware of the risks associated with corporate bond investments. Certain risks are outlined below but you should consult the offering documents of a particular issuance for a more detailed discussion of applicable risks.

- **Credit Risk:** Corporate bonds are backed by the financial health of the issuing company. If the company defaults, the investor may lose all future interest payments as well as the return of principal, though, as discussed earlier, in the event of default, an investor's position may be protected, in part, by seniority in the capital structure or collateral specifically pledged to the bondholders. Credit risk is typically the dominant risk associated with corporate bond investments and the key driver of how much yield relative to the rest of the bond market that the security pays to investors to assume this risk. This may be particularly significant for high yield or "junk" bonds. **Credit risk may increase or decrease over time due to changes in any or all of the risk variables.**

- **Pre-Payment Risk and Re-investment Risk:** As previously discussed, some corporate bonds include call features that permit the issuing company to call back bonds before maturity. Typically, a company would do this if interest rates have fallen in order to re-issue new debt at a lower rate. Therefore, if debt is called, it likely means the investor will need to consider how to re-invest the returned capital in a lower interest rate environment. The investor bears the risk that he or she will not be able to find an equally attractive investment target.

- **Interest Rate Risk:** The value of bonds will generally fall if interest rates rise, and the value will generally rise if interest rates fall. No one can predict whether interest rates will rise or fall in the future.

- **Liquidity Risk:** Some kinds of corporate bonds – especially the more specialized and risky issuances – can be quite illiquid. Generally, smaller company issuances and subordinated issuances will be less liquid than the higher quality, senior issuances. If a bond is illiquid in the secondary market, the investor may not be able to easily sell a bond to raise cash if circumstances required it.

- **Event Risk:** This is the risk the value of a bond will decrease due to specific events which arise and hamper a company's ability to service its debt obligations. This exposes investors to greater risk and, possibly, lower bond valuations. Examples of event risk: a corporate take-over of the issuing company, a natural disaster impacting a company's core operations, a terrorist attack seriously undermining a company's customer base, or a key technology innovation making a company's products obsolete.

- **Market Risk:** This is the risk the bond may be worth more or less at any point in time than what the investor paid due to changes in market interest rates. Duration is a key metric indicating a bond price's sensitivity to interest rate changes, and therefore, a way to gauge the degree of market risk inherent in a bond position. Generally, bonds with longer maturities tend to have a higher duration than bonds with shorter maturities. Additionally, lower-coupon bonds tend to have higher duration than higher-coupon bonds.

NEXT STEPS

To learn more about corporate bonds, contact your financial professional who can answer questions and provide access to current offerings, as well as assist you in structuring a portfolio that meets your individual investment goals and risk tolerance.

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