PruFund investment insights: a closer look at bonds

a 10 minute read

Bonds are one of the main types of assets that the PruFund range of funds invests in. We know that investments and the related terminology can be complex, and that's why we want to explain things clearly for you. Your financial adviser has given you this article so that you can find out about bonds. Read on to learn more.

Introducing Bonds

Fixed income is a type of investment that pays out interest payments on a regular basis. The most common type of fixed-income investment is a bond. Bonds offer a way for companies or governments to raise funds. Companies need funds for many reasons, such as expanding manufacturing, investing in research, or financing new acquisitions. Governments use bonds to raise funds to support spending and other obligations.

When investment managers buy bonds for PruFund funds, they're essentially lending a company or a government money in return for interest payments. So a bond is like a tradable loan. When a bond matures (at the date when the company or government makes its final interest payment), we expect to get back the money invested. The period over which the bond will mature is set when the bond is issued – it could be as short as a few months or as long as 30 years. Sometimes, bonds are sold before they mature. When this happens, the new owner receives the future interest payments along with the original investment when the bond matures.

Over the coming pages, we explore the different types of bonds, why the PruFund range of funds invests in them on your behalf, and our robust process for managing these investments.

Your financial adviser has given you this article to provide some more context about bonds and how they work. We recommend that you read it and then get in touch with your adviser if you have any questions. Your adviser is best placed to help you understand what investment options are right for you. **Please bear in mind that the value of your investments can rise as well as fall, and you may get less back than what you invest.**

Learn more about bonds

Why do PruFund funds invest in bonds?

PruFund funds invest in bonds because they offer steady income through their interest payments and are less likely than shares to rise and fall rapidly in value. Although generally a more predictable investment, they're likely to provide smaller returns than most shares.

> Ask your adviser to send you our article 'PruFund investment insights: a closer look at shares' if you'd like to learn more about shares too.

Which bond types do PruFund funds invest most in?

The PruFund range of funds mainly invest in corporate bonds but does have exposure to government bonds, both in developed and emerging markets. In 2023, we introduced a new allocation to UK Government Bonds due to them having attractive valuations and since then have continued to add to this exposure.

How do corporate bonds work?

Corporate bonds can be divided into two broad classes – investment grade and high yield:

- **Investment-grade bonds** are issued by companies less likely to default (to fail to repay their loans or interest payments) and tend to offer a lower risk option.
- **High-yield bonds** are issued by companies thought to be more likely to default, so they have to offer higher interest payments to attract investment and compensate for more risk.

In both cases, when a company issues bonds, it's borrowing money from the investors who buy them. That provides the company with funds it needs to improve or expand its business. The company will hope to make more money through the improvements than it loses by paying interest on its bonds.

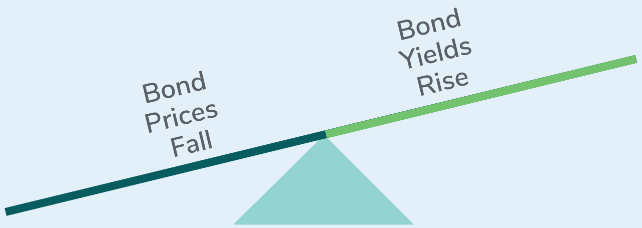
Learn more about bonds (continued on next page)

Learn more about bonds (continued from previous page)

What impact do bank interest rates have on bond investments?

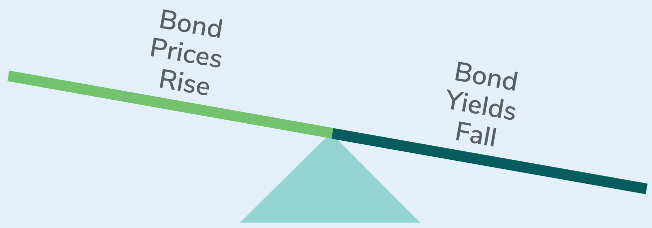
Bonds are attractive to investors because they typically offer a higher fixed-interest rate than what cash-based savings can earn, although with more potential to lose money. Here we take a look at what happens to bonds when bank interest rates rise or fall:

If interest rates RISE:



- A bond that has already been issued becomes less valuable when bank interest rates rise. Investors will no longer be attracted by the lower fixed-interest rate paid by the bond, resulting in a decline in its price.

If interest rates FALL:



- A bond's fixed-interest rate becomes more attractive if bank interest rates fall, which drives up the price of the bond.

Falling bond prices don't matter to investors if they intend to hold their bonds until they mature. But investors sometimes need to sell some of their investments. If this is at a time when bank interest rates have risen, investors may have to sell some bonds at lower prices than they paid for them.

So, as we've seen, the biggest risk to bond investments comes from rising bank interest rates. Central banks could raise interest rates to control inflation. Inflation is the general increase in the price of goods and services in an economy. Ask your adviser to send you our article about how the current climate of higher inflation and low interest rates impacts cash-based savings, if you want to know more.

Diversification explained

We invest in bonds issued around the world

The PruFund range of funds invests in bonds in over 40 countries throughout Europe, North America, South America, Asia and Africa. The majority of these bonds are corporate bonds. By investing in bonds issued by companies around the world, we aim to diversify (or vary) our investments so that they won't all be affected by the same developments at the same time.

Of course, there are no guarantees, and if companies that issue bonds come under severe financial pressure, they could fail to make their interest payments or repay their loan. But by spreading out investments across many different companies and countries, we aim to ensure that PruFund funds won't be affected to a large degree by any individual bond default.

Most of PruFund funds' bond investments are in developed markets. These include the UK, the US, Japan and many European countries. All of these countries have mature economies and are home to many well-established companies.

We also invest in emerging markets, including many countries in Asia and Africa. Bonds issued in these countries tend to offer higher yields to compensate for a higher risk of default. The newest emerging markets are known as frontier markets. These tend to be markets in the smaller, and less accessible, countries of the developing world and they offer even higher yields than more established emerging markets. PruFund funds have small investments in frontier markets.

Breakdown of PruFund Growth Fund bonds portfolio by market

Please note figures may not add up to 100% due to rounding.

Source: M&G Treasury & Investment Office, 30 June 2024.

PruFund funds also invest in bonds issued by some global organisations, such as the Asian Development Bank or the European Bank. These bonds, and the organisations that issue them, are known as 'supranational'. This means they have power or influence that transcends national boundaries or governments.

Our investing process in practice

The different aspects of investing we've described give us a wide variety of building blocks with which to construct the PruFund range of funds' bond portfolio. This helps ensure that the risks and opportunities in our investments are appropriately spread to balance the potential risks and rewards for you.

Most of PruFund funds' bond investments are managed by M&G Investments

M&G Investments is one of the largest bond managers in Europe with a large and well-resourced team of analysts.

When assessing the bonds in which it invests on behalf of PruFund funds, the M&G Investments team researches the quality of the country or company that issues a particular bond. It does this to be as sure as possible that the country or company is not going to default by failing to pay the interest due on its bonds. This research is a crucial activity because it helps to avoid PruFund funds making losses in its bond investments.

In some cases, we invest in established funds. In others, we work with investment managers to create new funds especially for the PruFund range of funds. These new funds target particular areas of the world's bond markets that may not be available otherwise, but we do this because we believe it will deliver a benefit to investors.

ESG factors are a critical consideration for us

Environmental, social and governance (ESG) concerns are important to many of our investors who want to invest in companies that are helping to solve some of the global challenges with a long term view and consideration of the future for people and the planet. So ESG is a crucial consideration for us when our managers decide where to invest your money.

At M&G Investments, our managers assess the ESG risks to which a bond issuer is exposed, and the degree to which these risks could affect PruFund's investments. And we set high standards for our other bond managers and they engage with the companies in which we invest about the full range of ESG issues.

It's always a good idea to know where your money is invested. If reading this article has made you want to know more about PruFund funds, you might also be interested in reading our regular report 'A closer look at PruFund: your quarterly market overview'. Contact your adviser if you'd like to receive it.

If you'd like to learn more

We hope that you've found this insight into bonds interesting and helpful. Please remember, if you have further questions, it's always best to speak to your adviser. Only your adviser will have a complete view of your situation and be able to answer questions with your financial goals in mind.

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