Exchange-traded Australian Government Bonds

Providing investors with security, liquidity and diversification | Version 2.0 – 14 December 2020

Exchange-traded Australian Government Bonds (AGBs) offer stable cash flows and the ability to reduce risk in your portfolio – without locking away your money for the term of the investment.

What are Exchange-traded AGBs?

Exchange-traded AGBs offer a convenient and accessible way to invest in Australian Government Bonds.

AGBs are debt securities issued by the Australian Government. Exchange-traded AGBs enable investors to gain beneficial ownership of an AGB in the form of a CHESS Depositary Interest (CDI). Holders of Exchange traded AGBs obtain all the economic benefits, including payments, attached to legal ownership of the AGB.

AGBs are considered to have the lowest possible credit risk of all debt-based investments being issued by the Australian Government. AGBs are therefore highly suitable as part of an investment portfolio seeking a secure, stable and reliable cash flow.

Due to their low credit risk, Exchange-traded AGBs can also help diversify your portfolio, offsetting the risk of other investments such as shares or property.

Types of Exchange-traded AGBs

There are two types of Exchange-traded AGBs:

1. **Exchange-traded Treasury Bonds** (TBs) are medium - to long-term debt securities with a fixed face value. They carry the same annual rate of interest over the life of the security, payable every six months.
2. **Exchange-traded Treasury Indexed Bonds** (TIBs) are medium- to long-term debt securities. Their face value is adjusted for movements in the Consumer Price Index (CPI). Interest is paid quarterly, at a fixed rate, on the adjusted capital value. At maturity, investors receive the face value of the security adjusted for CPI movement over the life of the bond.

Why invest in Exchange-traded AGBs?

- **Receive regular, stable payments:** AGBs provide investors with a secure income stream through regular coupon payments. In comparison, returns from share investments can fluctuate in line with the profitability of the company.
- **Reduce risk through diversification:** AGBs may help reduce overall portfolio risk. By combining AGBs and other investments such as shares, you may be able to maximise their return whilst minimising risk.
- **Avoid locking away your money:** Exchange-traded AGBs can be sold at any time the ASX bond market is open. This means your money is not locked away as it is with some other interest-earning investments.
- **Hedge against inflation:** the face value of TIBs is automatically adjusted for movements in CPI, meaning the value of your investment is protected from the effects of inflation.

Key characteristics

- **Security type:** CHESS Depository Interest over Australian Government Bonds.
- **Underlying security:** Australian Government Bonds.
- **Face value:** TB = $100. TIB = $100 plus CPI adjustment.
- **Coupon:** interest paid to the holder, expressed as a fixed percentage of the face value of the AGB. For example, a TB with a face value of $100 might pay a coupon of 6% per annum. This is $6 in interest per year, made up of two half-yearly payments of $3.

- **Yield:** the return received on an AGB. The yield is based on the price paid for the AGB and the payments (coupons) received if the AGB is held to maturity.
- **Maturity date:** the expiry date of the AGB, which sees the face value of the AGB paid to the holder.
- **Market (or gross) price:** this is the total amount that an investor pays for an Exchange-traded AGB on the ASX market. The purchase price includes two components:

1. **Capital price:** the price of the AGB as estimated by the market based on a number of variables including interest rate and maturity date.
2. **Accrued interest:** the amount of interest accumulated on the AGB since the last coupon payment. Because interest is paid at regular intervals, the AGB price includes a daily accrual of interest owed. The market price should fall immediately when the AGB goes 'ex-interest'.

Buying or selling on ASX

You can buy or sell Exchange-traded AGBs on ASX the same way you buy or sell shares. Trades are cleared by ASX Clear and settled through CHESS.

You should always be able to buy or sell Exchange-traded AGBs because they are based on one of the deepest and most liquid bond markets in Australia. This means there is typically a high level of stock availability and liquidity.

Additionally, liquidity is supplemented by ASX-appointed market makers who source prices from the wholesale bond market.

Case study – buying exchange-traded Treasury Bonds

On 26 May 2009, an investor purchases 1,000 Exchange-traded TBs with the following characteristics:

Characteristics	Details
Coupon	6%
Coupon frequency	Six-monthly, paid on 15 February and 15 August
Maturity date	15 February 2017
Face value	$100

The market price at the time of purchase is $108.172, making the total purchase cost $108,172 (excluding brokerage and fees). The market purchase price includes accrued interest of $1,657. The price represents a yield to maturity of 4.97% per annum.

Income stream

A coupon of 6% per annum is paid twice per year. The income stream is calculated as follows:

(number of Exchange-traded TBs x face value) x (coupon rate/coupon frequency)

= (1,000 x $100) x (0.06/2)

= $3,000 every six months

The investor will receive a payment of $3,000 twice per year until the Exchange-traded TB matures.

Payment at maturity

At maturity, the investor will receive the Exchange-traded TBs' face value and the final coupon. This is calculated as follows:

[(number of Exchange-traded TBs x face value) x (coupon rate/coupon frequency)] + (number of bonds x face value) = [(1,000 x $100) x (0.06/2)] + (1,000 x $100)

= $3,000 + $100,000

= $103,000

Summary

The investor paid $108,172 for 1,000 Exchange-traded TBs, which were held till maturity in 2017. During the life of the TB, the investor would receive $30,000 in coupon payments and the TB's face value (totalling $100,000) at maturity. The return on the original investment is 4.97% pa.

Note that the yield (4.97%) is lower than the coupon (6%). This is because the purchase price ($108,172) was higher than the TB's maturity value ($100,000).

About the example

This example uses illustrative rates and figures to demonstrate one particular scenario. You should use rates and figures applicable at the time to assess the merits of any transaction you may enter into.

This case study does not take into account any losses or gains to the value of an AGB as a result of changing market conditions or interest rates.

Risks

Like any investment, Exchange-traded TBs carry risks that you must understand before investing. In this example, if the price of the TB falls due to rising interest rates, you would suffer a capital loss if you chose to sell the TB before it matured.

You should obtain independent advice from a professional adviser before making any financial decision.

For more information

> Consult your adviser or broker.
> Review the investor information statement produced by the Australian Government.
> Go to www.australiangovernmentbonds.gov.au for more information from the Australian Government.
> Visit www.asx.com.au for investor education, product details, research, performance figures, news and prices.
> Contact ASX customer service on 131 279 or info@asx.com.au

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