

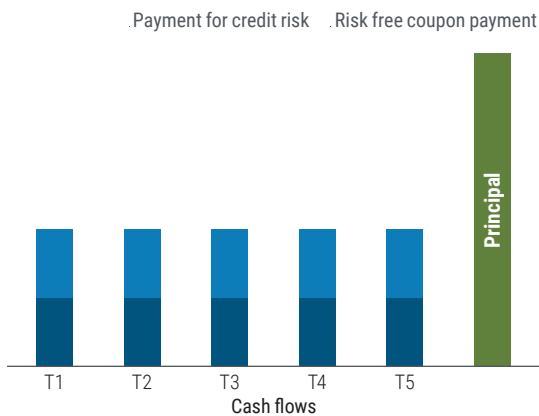
Credit Risk in Bonds: Ratings and Credit Spread Explained

Credit ratings and credit spreads help to explain credit risk in bonds – that is, the risk of not getting your money back. Credit ratings indicate an issuer’s ability to repay its debt, while credit spreads show how much extra yield investors demand for taking on that risk.

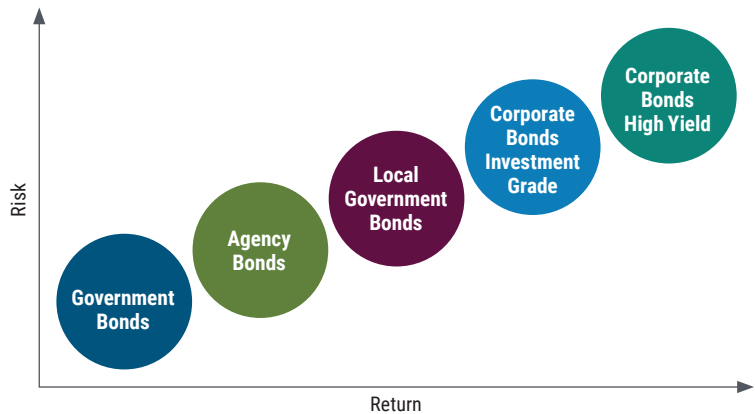
What is credit risk?

Credit risk is the risk that a bond issuer may fail to make interest or principal payments.

- At one end of the spectrum are lower-yielding but highly rated government-guaranteed bonds, which are backed by the full faith and credit of a government and are generally considered lower risk.
- At the other end are higher-yielding bonds issued by lower-rated companies, which offer more income but carry a higher risk of default.



For illustrative purposes only.



Credit ratings: A starting point

Credit ratings are opinions issued by independent agencies about an issuer’s creditworthiness. Higher ratings generally indicate lower credit risk, while lower ratings indicate higher credit risk.

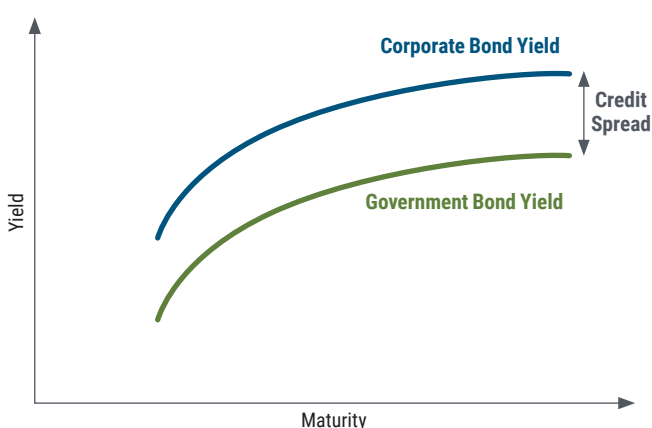
Ratings provide a useful starting point, but they are not guarantees and can change over time.

	S&P	Moody’s	Meaning
Investment Grade	AAA	Aaa	Best quality, with the smallest risk; issuers stable and dependable
	AA	Aa	High quality, with slightly higher degree of long-term risk
	A	A	High quality, with many strong attributes, but somewhat vulnerable to changing economic conditions
	BBB	Baa	Medium quality, currently adequate
Non-Investment Grade (High Yield)	BB	Ba	Some speculative element, with moderate security
	B	B	Able to pay now but a risk of default in the future
	CCC	Caa	Poor quality, clear danger of default
	CC	Ca	Highly speculative quality, often in default
	C	C	Lowest-rated with poor prospects of repayment though may still be paying
	*	D	In default

Source: PIMCO. For illustrative purposes only.

Credit spreads: The market’s view

A credit spread is the difference in yield between a bond issued by a company and a government bond of similar maturity. In simple terms, credit spreads show how much extra yield investors require to take on credit risk.



Considerations for investors

- **Credit quality matters:** Higher-rated bonds generally offer lower yields but greater stability, while lower-rated bonds offer higher yields to compensate for higher risk.
- **Market conditions can change:** Credit spreads can widen or narrow even if a bond’s credit rating stays the same, reflecting shifts in economic outlook or investor sentiment.
- **Diversification helps manage risk:** Many investors manage credit risk by spreading exposure across different issuers, sectors, and rating levels instead of depending on a single bond or credit rating.

Bottom line

For bond investors, credit ratings provide a starting point for understanding credit quality, while credit spreads help gauge whether the extra yield offered reasonably compensates for that risk. Credit ratings and spreads provide useful signals, but neither should be viewed in isolation.

- Widening spreads generally indicate increasing perceived risk; bond prices tend to fall.
- Narrowing spreads indicate lowering perceived risk; bond prices tend to rise.

Past performance is not a guarantee or a reliable indicator of future results.

All investments contain risk and may lose value. Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and low interest rate environments increase this risk. Reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. **Equities** may decline in value due to both real and perceived general market, economic, and industry conditions. **High-yield, lower-rated, securities** involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. **Management risk** is the risk that the investment techniques and risk analyses applied by an investment manager will not produce the desired results, and that certain policies or developments may affect the investment techniques available to the manager in connection with managing the strategy. **Diversification** does not ensure against loss. **Investors should consult their investment professional prior to making an investment decision.**

The credit quality of a particular security or group of securities does not ensure the stability or safety of an overall portfolio. The quality ratings of individual issues/issuers are provided to indicate the credit-worthiness of such issues/issuer and generally range from AAA, Aaa, or AAA (highest) to D, C, or D (lowest) for S&P, Moody's, and Fitch respectively.

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