

FinancialQuotient

What is coupon rate?

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WHAT DOES IT MEAN?

Coupon rate is the promised annual interest payment as a percentage of the par value of the bond. Although the coupon rate is mostly quoted in annual terms, the exact coupon received by investors is dependent on the frequency of the payments.

For example, if the coupon rate is 4

per cent and the payment frequency is semi-annual, investors will receive 2 per cent every six months. For most bonds, the rate is fixed at the time of issuance, but there are some bonds with rates pegged to benchmarks such as the Singapore Interbank Offered Rate (Sibor) with or without some credit spread.

WHY IS IT IMPORTANT?

Choosing a bond with a certain

level of coupon rate can help investors reduce their exposure to interest rate fluctuation. If investors expect the interest rate to increase shortly, it is better to hold bonds with high coupon rates as the price drop will be lower.

On the other hand, if the interest rate is expected to decrease, investors should choose bonds with lower coupon rates. This will enable them to obtain higher returns

and reduce the uncertainty in reinvesting the coupon received when the market has a low interest rate.

As it may not be convenient for investors to reinvest the coupon received regularly, some may want to consider bond portfolios that automatically reinvest the coupon receipts. Such a feature would be more valuable for bonds with higher coupon rates.

IF YOU WANT TO USE THE TERM, JUST SAY:

“The selection of bonds with different coupon rates can affect investors’ returns due to interest rate fluctuations and uncertainty in reinvestment of the coupons received.”

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