LM03 · FIXED INCOME · CFA LEVEL I

Fixed-Income Issuance and Trading

How fixed-income markets are segmented; how bonds are issued in primary markets; and how they trade in secondary markets.

Learning Outcomes

LOS a Describe fixed-income segments, issuers, investors, and interactions

LOS b Describe primary bond issuance mechanisms and secondary markets

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LOS A · CLASSIFYING FIXED-INCOME MARKETS

Three Dimensions of Classification

Fixed-income markets are typically classified along three dimensions: issuer type, credit quality, and time to maturity. Additional features sometimes used include currency, geography, and ESG.

Issuer type

- Households
- Non-financial corporates
- Government
- Financial institutions

Credit quality

- **Investment grade** — higher credit quality (Moody's Baa3 / S&P BBB− or above)
- **Non-investment grade (high yield)** — lower quality / higher yield

Maturity

- **Money market** — ≤ 1 year original
- **Capital market** — > 1 year original

LOS A · FIXED-INCOME INVESTORS

How Different Investors Position Themselves

Fixed-income investors take positions across the credit and maturity spectrums to gain exposure to specific risks and match the cash flows of known future obligations.

- **Pension funds and insurance companies** — long horizons; prefer fixed-income instruments with fixed periodic coupon cash flows and a maturity profile that **matches long-term liabilities** (asset-liability matching).
- **Hedge funds and distressed-debt funds** — may take additional credit risk at any point on the maturity spectrum to pursue higher expected return.
- **Banks** — fund short/medium-term loans; participate actively in money markets, repo, and interbank lending.
- **Mutual funds / ETFs** — intermediate investors across the curve.
- **Retail** — typically via funds and ETFs.

LOS A · FIXED-INCOME INDEXES

Fixed-Income Indexes

Like equity market indexes, fixed-income indexes also track the returns of groups of securities that meet their inclusion criteria. They are used to:

- **Evaluate market performance**.
- **Benchmark** the performance of investments and managers.
- Serve as the foundation for **indexed investment strategies**.

Indexes can be classified as **broad-based, aggregate** indexes with a vast number of constituents, or **narrower** indexes that focus on issuer type, credit quality, or maturity.

CHECKPOINT 1

Quiz 1: Segments & Investors

Answer all questions to test your understanding. Your score updates on the final step.

Q1. Fixed-income investors with the *longest* investment horizon typically include:

Q2. Fixed-income markets are commonly classified along all of the following dimensions *except*:

Q3. A bond rated BB by S&P is *most accurately* described as:

Q4. A broad-based aggregate fixed-income index *most accurately*:

Q5. A hedge fund that buys deeply distressed subordinated corporate bonds is *most likely* seeking:

LOS B · PRIMARY MARKET MECHANISMS

Primary Markets — How Bonds Are First Sold

Primary markets are where bonds are sold for the first time by an issuer to raise capital. Issuance methods split into public offerings and private placements.

Public offerings

Any member of the public may buy the bonds. Four main types:

1. **Underwritten offerings** — the investment bank **buys the entire issue** and takes the risk of reselling it to investors or dealers.
2. **Best-effort offerings** — the investment bank serves only as a **broker** and sells the issue only if it is able to do so. (Both underwritten and best-effort are frequently used in corporate issuance.)
3. **Shelf registrations** — the issuer files a single document with regulators that allows for **additional future issuances** without re-filing.
4. **Auction** — price discovery through bidding; **frequently used for sovereign bonds**. Bidders may be competitive (specify price + quantity) or non-competitive (accept auction price).

Private placement

Securities are sold directly to qualified investors (typically large institutions). Not registered with the general public; less regulatory burden; typically less liquid.

LOS B · SECONDARY MARKETS & SETTLEMENT

Secondary Markets for Bonds

- Markets in which **existing bonds are traded among investors**.
- Most bonds are traded in **over-the-counter (OTC) dealer markets**. Some trade on public exchanges.
- **Institutional investors** are the major buyers and sellers of bonds in secondary markets.
- **Electronic trading platforms** have gained share, but OTC dealer trading remains dominant for many bond types.

Settlement

- **Government bonds** typically settle **T+1** (one day after trade).
- **Corporate bonds** typically settle **T+2**.
- Settlement includes transfer of ownership against payment of the full price (flat price + accrued interest).

CHECKPOINT 2

Quiz 2: Issuance

Answer all questions to test your understanding. Your score updates on the final step.

Q6. In an **underwritten** public bond offering, the investment bank:

Q7. A shelf registration *most accurately* allows the issuer to:

Q8. Most bonds in secondary markets trade:

Q9. Sovereign bond auctions typically feature both:

Q10. A private placement of corporate debt is *most likely* to be:

LOS A · HOW MARKETS CONNECT

How Issuers and Investors Interact

Issuers and investors rarely interact directly — fixed-income markets are intermediated:

- **Investment banks** originate and distribute primary issues (underwriters, book-runners).
- **Dealers / broker-dealers** stand between buyers and sellers in secondary OTC markets, providing liquidity.
- **Credit rating agencies** assess default risk and inform pricing.
- **Trustees and custodians** hold and safeguard bondholder rights.
- **Clearinghouses** settle trades and reduce counterparty risk.

CHECKPOINT 3 · INTEGRATION

Quiz 3: Synthesis

Answer all questions to test your understanding. Your score updates on the final step.

Q11. Corporate bond settlement is *most commonly*:

Q12. A bank offering short-term loans to other banks is *most likely* participating in the:

Q13. Which of the following is *most consistent* with a narrow fixed-income index?

Q14. In fixed-income primary markets, a best-effort offering *most accurately* places the *reselling risk* on:

Q15. ESG classification of fixed-income securities is *best* considered:

MODULE COMPLETE

Your Scorecard

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LM03 Key Takeaways — Exam-Ready Cheat Sheet

Classification

Three standard dimensions: **issuer type** (households, non-financial corp, gov't, financial), **credit quality** (IG vs. HY), **maturity** (MM ≤ 1yr, CM > 1yr). Optional: currency, geography, ESG.

Primary Market Mechanisms

Underwritten — bank buys issue. **Best-effort** — bank is broker. **Shelf registration** — future issuance approved. **Auction** — for sovereign (competitive + non-competitive bids). **Private placement** — qualified institutions.

Secondary Markets

Mostly **OTC** dealer markets; some exchange trading; electronic platforms growing. Settlement: gov T+1; corp T+2.

Exam Checklist

Pension / insurance → long horizons, ALM. Banks → money market / interbank. Hedge / distressed → credit risk for return.

Step 1 of 11