ASSESSING FLOATERS

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EXECUTIVE COACH & INVESTMENT CONSULTING

FIXED INCOME COACHING PROGRAM

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FOUNDER AND PRINCIPAL

CHARACTERISTICS OF A FLOATER

- Considered to be more “defensive” in a bond portfolio

  - ❑ Periodic reset date reduces sensitivity in rates
  - ❑ Helps to hedge out inflation

CHARACTERISTICS OF A FLOATER

- Coupon Formula
- Quoted Margin
- Discount Margin or Required Margin
- Index Duration
- Spread Duration

FLOATERS FEATURES

Coupon Rate = Reference Rate + Quoted Margin (bps)

Common Reference Rates (Benchmarks)

- One-month LIBOR
- Three-month LIBOR
- Fed Funds Rate
- Treasury bill

Quoted Margin is the adjustment the issuer agrees to price the floater using a relevant reference rates

WHAT AFFECTS A FLOATER’S PRICE?

1. Remaining time to next coupon reset date
2. When there is a change in the market’s required margin
3. Whether the cap or floor is reached

WHAT AFFECTS A FLOATER'S PRICE?

1. Remaining time to next coupon reset date

One month on,

- Market requires **2.7% yield** on comps with 11 months to maturity
- Price will decline

Floater resets 12 month later

Consider 5y IG FRN reset today (1y Treasury + 50bps)

- Assume Treasury at 2%
- **Coupon rate is 2.5%**

WHAT AFFECTS A FLOATER'S PRICE?

1. When there is a change in the market's required margin

Example

- FRN whose coupon formula is 3ML + 40 bps
- If market's required margin increases to 50 bps,
    - ❑ FRN would offer a below-market margin and its price will go below par

Required Margin depends on

i. Credit quality of the issue
ii. Any embedded call or put option
iii. Liquidity of the issue