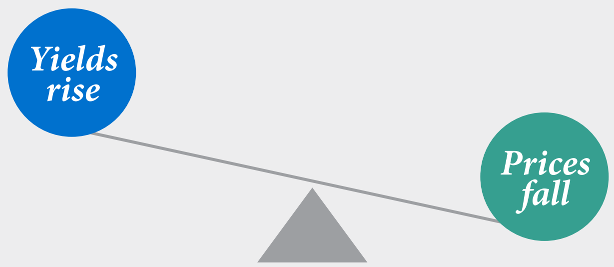
PIMCO

5 things *you need to know* about rates

When interest rates move, it's not just borrowers who are concerned with the outcome. As an important driver of bond prices, interest rates are also closely watched by bond investors. ***If you are investing in bonds, here are five key things you need to know about rates.***

INTEREST RATES AND BOND PRICES

One of the key drivers of bond pricing is interest rates. If rates rise, older bonds with lower rates will drop in price to compensate for the lower coupon payments (and vice versa).



THE YIELD CURVE

The yield curve plots the interest rates for similar quality bonds against their maturities (years to expiration). There are three main types of yield curves.

NORMAL YIELD CURVE

Seen during periods of economic expansion, it indicates that long-term bond yields may continue to rise.

INVERTED YIELD CURVE

Seen during periods of recession, it indicates that long-term bond yields are expected to fall.

FLAT YIELD CURVE

Seen when the economy is transitioning from expansion to slowdown (and vice versa).

THE INFLATION DOUBLE THREAT

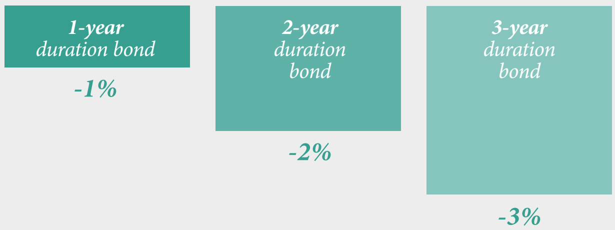
1. *Inflation erodes the purchasing power of future income payments from bonds.*

2. *Inflation can lead to interest rate increases which, in turn, push down bond prices.*

DURATION RISK

Duration risk reveals how sensitive a bond is to interest rate movements. In general, the higher the duration, the more the bond value will fall if interest rates rise.

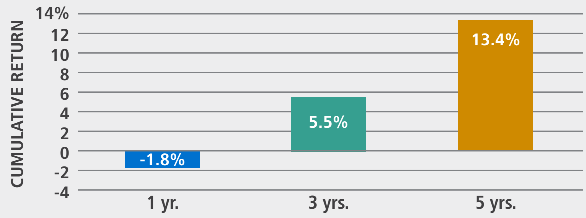
HOW A 1% RISE IN INTEREST RATES IMPACTS BONDS WITH DIFFERENT DURATIONS



RISING RATES

Rising rates don't have to mean bad news for bond investors. As the chart shows, a fixed interest investment may decline in market value in the short term because the existing bond holdings fall in price. However, higher interest rates will lead to a higher yield on the invested bonds in subsequent periods. Investors can also reinvest their coupons and maturing bonds into higher-yielding securities, which can return a bond portfolio back to growth more quickly.

THE UPSIDE OF RISING RATES



Hypothetical example for illustrative purposes only. Source: PIMCO, as of 31 December 2016. The chart shows the estimated performance of the Bloomberg Barclays U.S. Aggregate Index assuming a parallel rate rise of 1%, and no further changes in rates thereafter. Credit spreads are assumed to remain constant.

P I M C O

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 the current low interest rate environment increases this risk. Current 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.

In the analysis contained herein, PIMCO has outlined hypothetical event scenarios which, in theory, would impact the index returns as illustrated in the analysis. No representation is being made that these scenarios are likely to occur or that the example accounts for all aspects of risk. Total returns are estimated by re-pricing key rate duration replicating portfolios of par-coupon bonds.

Hypothetical and simulated examples have many inherent limitations and are generally prepared with the benefit of hindsight. There are frequently sharp differences between simulated results and the actual results. There are numerous factors related to the markets in general or the implementation of any specific investment strategy, which cannot be fully accounted for in the preparation of simulated results and all of which can adversely affect actual results. No guarantee is being made that the stated results will be achieved.

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