Fixed-Income Security

**What is a 'Fixed-Income Security'**

A fixed income security is an investment that provides a return in the form of fixed periodic payments and the eventual return of principal at maturity. Unlike a variable-income security, where payments change based on some underlying measure such as short-term interest rates, the payments of a fixed-income security are known in advance.

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**BREAKING DOWN 'Fixed-Income Security'**

As the name suggests, a fixed income security is a debt instrument that generates fixed returns in the form of interest payments to investors. Firms raise capital from issuing [fixed income](https://www.investopedia.com/terms/f/fixedincome.asp) products to lenders who are compensated with interest payments. The issuer promises to repay the principal on an agreed date in the future.

**Types of Fixed-Income Securities**

The most common type of fixed income securities are [bonds](https://www.investopedia.com/terms/b/bond.asp). A bond is an investment product that is issued by corporate and governmental entities to raise capital to finance and expand their operations and projects. The borrower, or issuer, promises to pay interest, called the [coupon](https://www.investopedia.com/terms/c/coupon.asp), on an annual or semi-annual basis until a set date. The issuer returns the principal amount, also called the face or [par value](https://www.investopedia.com/terms/p/parvalue.asp), to the investor on the [maturity date](https://www.investopedia.com/terms/m/maturitydate.asp).

Bonds can be broken down into [corporate bonds](https://www.investopedia.com/terms/c/corporatebond.asp) and [government bonds](https://www.investopedia.com/terms/g/government-bond.asp). Corporate bonds are issued by companies and can either be investment grade on non-investment grade bonds. Investment grade bonds are issued by stable companies with a low risk of default and, therefore, have lower interest rates than non-investment grade bonds. Non-investment grade bonds, also known as [junk bonds](https://www.investopedia.com/terms/j/junkbond.asp) or high-yield bonds, have very low credit ratings due to a high probability of the corporate issuer defaulting on its interest payments. For this reason, investors in high-yield bonds typically require a higher rate of interest for taking on the higher risk posed by these debt securities. Corporate bonds trade on major exchanges, and have $1,000 par values.

The [municipal bond](https://www.investopedia.com/terms/m/municipalbond.asp) is an example of a government bond. Municipal bonds are issued by states, cities, and counties to fund capital projects, such as building roads, schools, and hospitals. The interest earned from these bonds are tax exempt from federal income tax. In addition, a muni bond investor may also have his interest earned exempt from state and local taxes if he resides in the state where the bond is issued. The muni bond has several maturity dates in which a portion of the principal comes due on a separate date until the entire principal is repaid. Munis have par values of $5,000 and trade [over-the-counter](https://www.investopedia.com/terms/o/otc.asp).

Another type of government bond is the [Treasury bond](https://www.investopedia.com/terms/t/treasurybond.asp) (T-bond) which has maturity dates of more than 20 years. The interest payment and principal repayment of T-bonds are backed by the full faith and credit of the US government which issues these bonds to fund its debts. Treasury bonds typically have par values of $10,000, and are sold on auction on [TreasuryDirect](https://www.treasurydirect.gov/" \t "_blank).

Other types of fixed income securities include Treasury bills, Treasury notes, certificates of deposit (CD), and preferred stock. The [Treasury bills](https://www.investopedia.com/terms/t/treasurybill.asp) (T-bills) and [Treasury notes](https://www.investopedia.com/terms/t/treasurynote.asp) (T-notes) are similar to the T-bond in that they are sold by the US government. The T-bill is a short-term fixed income security that matures within one year from issuance, and typically sells [at a discount](https://www.investopedia.com/terms/a/at-a-discount.asp) to par. The Treasury notes have maturity dates of 10 years or less, and like Treasury bonds, can be issued at a discount, [at a premium](https://www.investopedia.com/terms/a/at-a-premium.asp), or at par.

A [certificate of deposit](https://www.investopedia.com/terms/c/certificateofdeposit.asp) (CD) is issued by a bank. In return for saving money with the bank for a predetermined period of time which could range from a month to 5 years, the bank pays interest to the account holder. CDs typically offer lower rates than bonds, but higher rates than traditional savings accounts.

[Preferred stocks](https://www.investopedia.com/terms/p/preferredstock.asp) are issued by companies, and provide investors with a fixed dividend, set as a dollar amount or percentage of share value on a predetermined schedule. The price of preferred shares is influenced by interest rates and inflation, and these shares have higher yields than most bonds due to their longer duration.

**Benefits of Fixed Income**

Fixed-income securities generate regular income, reduce overall risk, and protect against [volatility](https://www.investopedia.com/terms/v/volatility.asp) of a portfolio. The securities can appreciate in value and offer more stability of principal than other investments. Corporate bonds are more likely than other corporate investments to be repaid if a company declares bankruptcy.

**Risks of Fixed-Income Securities**

The generally low risk of investing in fixed-income securities results in low returns and slow [capital appreciation](https://www.investopedia.com/terms/c/capitalappreciation.asp). A principal balance may be tied up for a long time, resulting in lost income by not investing in other securities. Interest rate fluctuations cause bond prices to change, potentially resulting in lost income by having money locked into a lower-interest bond and not being able to invest in a higher-interest bond.

Bonds issued by a high-risk company may not be repaid, resulting in loss of principal and interest. Investing in [international bonds](https://www.investopedia.com/terms/i/internationalbond.asp) may result in losses due to exchange rate fluctuations. For example, if a U.S. investor owns bonds denominated in euros, and the euro decreases in value relative to the U.S. dollar, the investor’s returns are reduced.

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