What are Bonds and GILTS?

Turbulence on the stock market always leads to greater interest in bonds and gilts: the fixed-interest-paying IOUs from companies and the Government. 

They are a halfway house between holding cash in banks and building societies and shares. Yet few investors understand how they really work. Bonds are a form of debt issued by companies and governments to raise money. If you buy one you are, in effect, lending money to the issuer.

In return, the issuer promises to pay you a set rate of interest each year and to repay your capital at a set date in the future.

However, the return is not necessarily guaranteed. Bonds issued by the British Government, called gilts, are as good as guaranteed, as the Government is unlikely to go bust. But corporate bonds, issued by companies, are only as safe as the company that issues them. Bondholders stand ahead of shareholders in the queue for repayment if a company goes bust, but it may turn out that there is nothing for anyone.

Bonds are usually issued at £100 each and pay back £100 when they mature, plus interest at a fixed rate each year until then. If you buy in the market for more than £100 after they are issued and hold the bond until maturity, you will lose money. If you pay less, you will make a profit.

Bond prices go up and down like share prices but not as much. The prices are linked to long-term interest rates. They go down when rates are rising, and up when interest rates are falling.

**Investing in bonds**

Anyone who wants a lower risk investment, or a fixed income should consider investing in bonds. Income from cash in the bank or building society fluctuates with interest rates. Income from bonds is fixed, so you know what you will be getting. Bonds may also make a modest capital gain if interest rates fall.

You can sell at any time, but the price you get will depend on prices in the market. If interest rates have risen, the value of the bond itself may have fallen. Any capital gains you make are tax-free on Government bonds and some corporate bonds, but the interest paid on a bond is taxable. If you hold bonds in the old Personal Equity Plans (Pep) or an Individual Savings Account (Isa), you will get your interest tax-free as well.

The easiest way to invest is via a corporate bond fund. However, these can hold up to only 50% in gilts and some do not hold any. Safety-first investors who want gilts can use a gilt fund. The disadvantage of funds (unit trusts and Oeics) is that there is no fixed maturity date, as with a directly held bond, so you don't know exactly what you will get back.

You can also hold gilts in an Isa if they have at least five years until they mature. To buy bonds yourself you must use a stockbroker. For gilts, you can use the [Bank of England](http://www.bankofengland.co.uk/).

*Updated March 2011, This is Money*