Are bonds safer than stocks?

Safety is an important aspect when it comes to an investment option. We run this filter on bonds and stocks, so that it makes the choice easier for you.

Stocks and bonds are two different instruments catering to different types of investors. Bonds are like fixed deposits, as the issuing company promises to repay the amount after a specific period, and pays interest until its maturity. Stocks, on the other hand are different altogether: prices keep fluctuating, and the issuing company is not obligated to pay dividends regularly.

Prima facie, bonds appear safer and more stable than stocks. However, this might not always be the case. While government bonds are usually secure, the stability of a corporate bond depends on the financial strength of the issuing company. Junk bonds are the riskiest type, which have a lower investment grade due to a high default risk. However, they provide a higher rate of return to attract investors.

Generally speaking, bonds are considered a safe bet compared to stocks, unless they are junk bonds. So let us make a comparison between junk bonds, the riskiest of bonds, and stocks. While stocks and junk bonds offer different levels of safety in different circumstances, it is important to take the following factors into consideration while selecting any one:

Company stability

While you can invest in stocks of companies with better stability, you do not enjoy this benefit while investing in junk bonds. This is because most companies issuing junk bonds have weak financial strength.

Bankruptcy

In case of bankruptcy, the company is obligated to repay its debt first. Since junk bond is a form of debt, its investors receive payments before shareholders. Usually, shareholders are last on the list of repayment.

Volatility

Some stocks are volatile, while some are stable in nature. However, junk bond prices change dramatically with change in the economic cycle. In a rising economy, the value of junk bonds increases significantly, whereas during times of recession, its value depreciates.

Junk bonds usually provide higher returns than many traditional investment instruments. Likewise, stocks too have the potential to grow significantly. While both these options come with a certain degree of risk, investing some amount of your total investment in both these instruments provides a balance to your portfolio.