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Risk-to-Price (“R2P”) scores are generated by a proprietary model that was developed to identify corporate bonds that have been potentially mispriced by the market. The model accomplishes this by decomposing bond’s pricing spreads into its market and credit risk components. The market risk component of a bond’s pricing spread is analyzed through the application of option adjusted spread (OAS) model and an assessment of bond price volatility. Once the market risk component is accounted for, the remaining spread component is considered to be explainable entirely in terms of credit risk. An R2P score is then calculated such that it indicates how well the spread at which the bond is being priced can be explained in terms of its market and credit risk components, and whether any potential pricing error may exist. Daily R2P scores are created for U.S. and European corporate debt issues by evaluating their probability of default, volatility and option-adjusted spread. Scores with a top percentile ranking can be interpreted to mean that the associated bonds better compensate the investor for the risks associated with investing in those bonds rather than bonds with lower scores. Scores with low percentile rankings can be interpreted to mean that the associated bonds more poorly compensate investors for risk. Raw R2P scores calculated at different points in time should not be directly compared with one another. Instead, they should be compared based on their respective percentile rankings.

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R2P Risk Disclaimer

In general the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities.) Fixed income securities also carry inflation risk and credit and default risks for both issuers and counterparties.

Lower-quality debt securities generally offer higher yields, but also involve greater risk of default or price changes due to potential changes in the credit quality of the issuer.

Credit and default risk
Corporate bonds are subject to credit risk. It's important to pay attention to changes in the credit quality of the issuer, as less creditworthy issuers may be more likely to default on interest payments or principal repayment. If a bond issuer fails to make either a coupon or principal payment when they are due, or fails to meet some other provision of the bond indenture, it is said to be in default.

Market risk
Price volatility of corporate bonds increases with the length of the maturity and decreases as the size of the coupon increases. Changes in credit rating can also affect prices. If one of the major rating services lowers its credit rating for a particular issue, the price of that security usually declines.

Event risk
A bond's payments are dependent on the issuer's ability to generate cash flow. Unforeseen events could impact their ability to meet those commitments.

Call risk
Many corporate bonds may have call provisions, which means they can be redeemed or paid off at the issuer's discretion prior to maturity. Typically an issuer will call a bond when interest rates fall potentially leaving investors with a capital loss or loss in income and less favorable reinvestment options. Prior to purchasing a corporate bond, determine whether call provisions exist.

Make-whole calls
Some bonds give the issuer the right to call a bond, but stipulate that redemptions occur at par plus a premium. This feature is referred to as a make-whole call. The amount of the premium is determined by the yield of a comparable maturity Treasury security, plus additional basis points. Because the cost to the issuer can often be significant, make-whole calls are rarely invoked.

Sector risk
Corporate bond issuers fall into four main sectors: industrial, financial, utilities, and transportation. Bonds in these economic sectors can be affected by a range of factors, including corporate events, consumer demand, changes in the economic cycle, changes in regulation, interest rate and commodity volatility, changes in overseas economic conditions, and currency fluctuations. Understanding the degree to which each sector can be influenced by these factors is the first step toward building a diversified bond portfolio.

Interest rate risk
If interest rates rise, the price of existing bonds usually declines. That's because new bonds are likely to be issued with higher yields as interest rates increase, making the old or outstanding bonds less attractive. If interest rates decline, however, bond prices usually increase, which means an investor can sometimes sell a bond for more than face value, since other investors are willing to pay a premium for a bond with a higher interest payment. The longer a bond's maturity, the greater the impact a change in interest rates can have on its price. If you're holding a bond until maturity, interest rate risk is not a concern.

Inflation risk
Like all bonds, corporate bonds are subject to inflation risk. Inflation may diminish the purchasing power of a bond's interest and principal.

Foreign risk
In addition to the risks mentioned above, there are additional considerations for bonds issued by foreign governments and corporations. These bonds can experience greater volatility, due to increased political, regulatory, market, or economic risks. These risks are usually more pronounced in emerging markets, which may be subject to greater social, economic, regulatory, and political uncertainties.

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