



Understanding Credit Ratings

What are credit ratings?

Credit ratings are the most common benchmark used to assess the ability of a bond issuer to make timely payments of interest and principal. As credit ratings are subject to change without notice it is important to review a bond's credit rating, and the effect a rating change could have on the bond, before you invest. In measuring credit quality, U.S. Treasury securities, which are backed by the 'full faith and credit' of the U.S. Government, are accepted within the investment community as the benchmark, against which the credit quality of all other fixed income securities are measured. Here, we take an informative look at the bond credit rating system.

An Overview of Rating Agencies

When considering a potential investment, investors should carefully compare the credit qualities of available bond issues before they invest. Credit quality can be implied, as in the case of U.S. Treasuries, or it may be specified through a rating assigned by a ratings agency. The SEC defines a Nationally Recognized Statistical Rating Organization (NRSRO) as an entity that meets guidelines deemed necessary to offer ratings upon issuers. Here we consider the ratings assigned by three NRSRO's:

- Moody's Investors Service ("Moody's")
- Standard & Poor's Corporation ("S&P")
- Fitch Ratings ('Fitch')

In determining the creditworthiness of an issuer, Moody's, S&P and Fitch focus on the issuer's overall financial condition, as well as that of the industry or sector in which the issuer operates. A rating represents the opinions of the rating agency at a particular point in time. Ratings on individual issues are continuously revised to reflect any industry, sector, company or municipal developments, and these ratings changes can have a distinct effect on a bond's market price. The rating agencies classify bond issues as either 'investment grade' or 'below investment grade.'

Investment Grade Bonds

These bonds are generally more appropriate for conservative clients. They typically provide the highest degree of principal and interest payment protection, and are generally the least likely to default.

Below Investment Grade Bonds

Securities rated below investment grade are often referred to as 'high yield' or 'junk' bonds and may be suitable only for aggressive investors willing to accept greater degrees of credit risk. Below investment grade bonds are considered speculative investments, involve a greater risk of default and tend to be more volatile than investment grade bonds. The yields on these bonds are generally higher to compensate for the additional risk.

See disclosures on final page.

Investment Grade		Rating
Highest Grade/Best Quality		
Moody's	These obligations are judged to be of the highest quality, with minimal credit risk.	Aaa
S&P	The issuer's capacity to meet its financial commitment on the obligation is extremely strong.	AAA
Fitch	Highest credit quality; denotes the lowest expectation of credit risk. Exceptionally strong capacity for payment of financial commitments.	AAA
High Grade/High Quality		
Moody's	These obligations are judged to be of high quality and are subject to very low credit risk.	Aa1 Aa2 Aa3
S&P	The issuer's capacity to meet its financial commitment on the obligation is very strong, differing from the highest-rated obligations only to a small degree.	AA+ AA AA-
Fitch	Very high credit quality; denotes expectations of very low credit risk. Very strong capacity for payment of financial commitments.	AA
Upper Medium Grade		
Moody's	Obligations rated 'A' are considered upper-medium grade and are subject to low credit risk.	A1 A2 A3
S&P	The issuer has strong capacity to meet its financial commitments. However, it is more susceptible to the adverse effects of changes in circumstances and economic conditions than higher-rated obligators.	A+ A A-
Fitch	High credit quality; denotes expectations of low credit risk. Strong capacity for payment of financial commitments.	A
Medium Grade		
Moody's	These obligations are subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics.	Baa1 Baa2 Baa3
S&P	Exhibits adequate protection parameters. Adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the issuer to meet its financial commitments.	BBB+ BBB BBB-
Fitch	Good credit quality; denotes that there are currently expectations of low credit risk. The capacity for payment of financial commitments is considered adequate but adverse changes in circumstances and economic conditions are more likely to impair this capacity.	BBB

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Below Investment Grade		Rating
Speculative Grade		
Moody's	These obligations are judged to have speculative elements and are subject to substantial credit risk.	Ba1 Ba2 Ba3
	These obligations are judged to be speculative and are subject to high credit risk.	B1 B2 B3
S&P	Less vulnerable to nonpayment than other speculative issues, however, the issuer faces major ongoing uncertainties or exposure to adverse business, financial or economic conditions which could lead to inadequate capacity to meet its financial commitment.	BB+ BB BB-
	These bonds are more vulnerable than 'BB' rated bonds, but the obligator currently has the capacity to meet its financial commitments. Adverse business, financial or economic conditions will likely impair that capacity.	B+ B B-
Fitch	Speculative. There is a possibility of credit risk developing, particularly as a result of adverse economic or market changes.	BB
	Highly speculative. Significant credit risk is present.	B
Highly Speculative Grade		
Moody's	These obligations are judged to be of poor standing and are subject to very high credit risk.	Caa1 Caa2 Caa3
	These obligations are highly speculative and are likely to be in, or very near, default, with some prospect of recovery of principal or interest.	Ca
S&P	The obligation is vulnerable to nonpayment, and is dependent upon favorable business, financial or economic conditions for the issuer to meet its financial commitments.	CCC+ CCC CCC-
	The obligations are highly vulnerable to nonpayment.	CC
	The obligations are currently highly vulnerable to nonpayment. May be used where a bankruptcy petition has been filed.	C
Fitch	Default is a real possibility. Capacity for meeting financial commitments is dependent on sustained, favorable business or economic conditions	CCC
	Default of some kind appears probable	CC
	Default is imminent	C
Default		
Moody's	These bonds are typically in payment default, with little prospect for recovery of principal or interest.	C
S&P	The issuer has selectively defaulted on a specific issue.	SD
	General default.	D
Fitch	These obligations are in payment default.	D

Disclosures – Important – Please Review

This material does not constitute the rendering of investment, legal, tax or insurance advice or services. It is intended for informational use only and is not a substitute for investment, legal, tax, and insurance advice.

State, national and international laws vary, as do individual circumstances; so always consult a qualified investment advisor, attorney, CPA, or insurance agent on all investment, legal, tax, or insurance matters.

The effectiveness of any of the strategies described will depend on your individual situation and on a number of other factors. After reviewing your personal situation, we may recommend that you not use any strategy in this document but instead consider various other strategies available through our practice.

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