

Perpetual knowledge bank series: liquidity risk

By Perpetual Asset Management

11 July 2022



Liquidity refers to an investor's ability to sell a bond quickly and at an efficient price. This is determined by the difference between the bid – or the price at which the market is willing to buy the security – and the offer, which is the price at which the market is willing to sell the security. It is commonly known as the bid offer spread.

For example, if a small gap exists between the prices buyers are bidding and the prices sellers are asking on large, actively traded bond issues, then the market has low liquidity risk. However, as the spread rises on less actively traded bonds, so does liquidity risk. If a market is not liquid, it can become very difficult to trade without adjusting the price. The other factor that has an impact on liquidity risk is the volume which can be transacted at a particular price or bid offer spread.

Generally, Australia's benchmark government and semi-government bond issues are very liquid with investment grade corporate bonds more liquid than non-investment grade bonds. This is because bonds can have many variables which can reduce the number of suitable buyers, some of whom may be mandated to consider only investment grade bonds or certain types of securities. Portfolio managers control liquidity risk by constantly monitoring security prices and allocations to different security types. Prices that are out of line with comparable securities, or 'stale' prices that stay static for long periods, can be tell-tale signs of risks, including liquidity risk.

This analysis has been prepared by [Perpetual Investment Management Limited \(PIML\)](#) ABN 18 000 866 535, AFSL 234426. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information.

The information is believed to be accurate at the time of compilation and is provided in good faith. This document may contain information contributed by third parties. PIML and PSL do not warrant the accuracy or completeness of any information contributed by a third party. Any views expressed in this document are opinions of the author at the time of writing and do not constitute a recommendation to act.

The product disclosure statement(PDS) for the Perpetual Diversified Income Fund issued by PIML, should be considered before deciding whether to acquire or hold units in the fund. The PDS and Target Market Determination can be obtained by calling 1800 022 033 or visiting our website <http://www.perpetual.com.au> .

No company in the Perpetual Group (Perpetual Limited ABN 86 000 431 827 and its subsidiaries) guarantees the performance of any fund or the return of an investor's capital. Past performance is not indicative of future performance.