

Oracle sells \$4 million in 10-year, \$1000 par value, 4.2% zero-coupon bonds to the SUNY endowment. What does this mean? Who did what? Who has an obligation? What's the timing? What prices?

<p>The Gap, Inc.          \$1000 face value          Matures 5/1/2020          Zero-coupon bond</p>
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This is a zero-coupon bond. What is it promising you?

Assume that the Gap issues debt that pays 2.3% higher than US Treasury bonds of similar maturity. On a day when US Treasuries are paying 2.5% interest...

...what is the interest rate of this bond?

...determine the price of the Gap bond assuming you are counting from 5/1 of this year.

Assume you bought the Gap bond and held it to maturity. What would be your profit?

Assume Dell also issues debt of the same length that pays 1.8% higher than US Treasuries of similar maturity on a day when Treasuries are paying 2.5% interest. What is the market saying about The Gap compared to Dell? How can you tell?

Determine the price of the Dell bond assuming you are counting from 5/1 of this year.

Assume you bought the Dell bond at that price and then sold it exactly two years later at the appropriate market price. Interest rates have not changed. Determine your profit on the bond in dollars.

Use the amount you initially invested in each bond to find the % profit for each one (and remember that this number is a multi-year profit %). What do you notice? Does this make sense?

Marking to Market – Changing the Value of your Investment

Remember: In the market, a thing is only worth what someone else will pay for it.

If Daniel and Ben have a great collection of Mets baseball cards that they bought for \$120 but then the baseball card world comes to its senses and realizes that nobody wants to buy Mets cards, their collection has no prospective buyers. No buyers means no value. The market price would be at or near \$0. Any valuation of those cards would have to be dramatically reduced from the \$120 they paid. Viewing those cards as an investment, they would have taken the L.



The Shum Investment Fund has a fixed income position of twenty \$1000 par-value Runner's World bonds which pay 3% above US Treasuries and mature in eight and a half years. As of this date, US Treasuries were paying 2%.

What is going to happen for the Shum Fund in eight and a half years?

Determine the interest rate that Shum's Runner's World bonds would pay.

Determine the Present Value of Shum's bonds.

Interpret this number you found up and to the right. What does it mean?

One day later, the Fed changes interest rates. Going forward, US Treasuries of this maturity were paying only 1.5% interest. (The point is that the date is almost the same, meaning don't change the exponent.)

Determine the interest rate that Shum's Runner's World bonds would pay.

Determine the Present Value of Shum's bonds.

Would you advise Shum put these bonds up for sale for a price of \$11,000? Why or why not?

Does an increase in the interest rate represent a good thing or a bad thing for Shum? Why? Why did the value move the way it did?