

True or False

Mark each statement as true or false. If it is false, male the appropriate changes to re-write it as a true statement.

e.g. President Obama is a republican. False
 President Obama is a democrat.

For an investor, a bond represents future income. _____

For a bond issuer, a bond is a way of getting cash in the future. _____

For a bond, a higher rate of interest represents a lower risk of default. _____

For a zero-coupon bond, the initial price is the face value. _____

For any bond, when the market interest rate increases, the price of the bond decreases. _____

Coupon bonds receive annual interest payments. _____

Coupon bonds are priced at a discount to their par value. _____

Zero-coupon bonds do not receive regular income. _____

On the day it is sold, determine the price of a \$1000 par value, 5-year zero-coupon bond that pays 4.2% annual interest.

Beacon Co.	\$1000
5 years	4.2%
zero-coupon bond	

Determine the price of this bond one year from the day it is sold. Assume it still pays 4.2% annual interest.

Interpret your answer. Why did the bond’s value change?

Assume you hold this bond. Two years after you initially bought it, would you sell it for \$850? Explain using evidence.

Comparing Bonds

View the two bonds below.

Luong Ltd.	\$1000
5 years	UST + 2.8%
zero-coupon bond	

Borrello Co.	\$1000
5 years	UST + 1.2%
zero-coupon bond	

Luong Ltd. issues bonds that pay 2.8% above the rate that US Treasury bonds (solid gold safe investments) with similar maturities pay. Borrello Co. issues bonds that pay 1.2% above the US Treasury rate.

What is the market saying about Borrello Co. compared to Luong Ltd.?

Think about it: What might be some reasons for that?

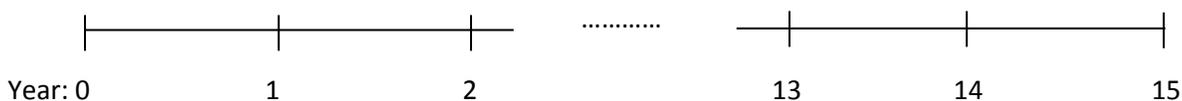
Assume Bayard bought 1000 Borrello bonds and Lacey bought 1000 Luong bonds. Both investors held their bonds to maturity. Determine the total profit each investor would make.

The MTA issues 50,000 of the following bonds to cover funding for the so-called 2nd Avenue subway (which has been in construction at least as long as I have lived in New York – 11 years).

MTA	\$1000
15 years	UST + 2%
Coupon bond	

- How much did the MTA take in on the date the bonds were issued?
- At the end of the each year, how much does each bond earn in interest?
- At the end of the each year, how much does the MTA pay in interest overall?

Draw a diagram for the first few years and last year of this bond:



Assuming an investor held one bond of this type to maturity. What would be the investor's profit and profit %?