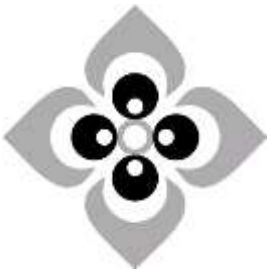

[Frequently Asked Questions]

[Bond Management (part-1)]

Subject:	Business Economics
Course:	B.A., 5th Semester, Undergraduate
Paper No. & Title:	Paper – 511 Investment Management
Unit No. & Title:	Unit - 1 Bond Management
Lecture No. & Title:	1: Bond Management (part-1)

Frequently Asked Questions

1. **Define Bond?**

   Bonds are a considered as an important element of any financial plan used for investment or to grow wealth. A bond in a lay man's term is a debt investment in which an investor makes loan to a corporation, government, or other organization in exchange for interest payments over a specified term along with the repayment of principal amount as on maturity date of the bond.

2. **What is Coupon rate?**

   The coupon rate is the yield that the bond pays on its issue date; however, this yield can change as the value of the bond changes and thus giving the bond's yield to maturity. Bonds having higher coupon rates are therefore more desirable for investors than those having lower coupon rates. Hence coupon rate is predetermined interest rate.

3. **Explain the concept of Yield.**

   When one buys a bond at par that is at face value, yield will be equal to the interest rate one will earn over the period of time. Yield of a bond is highly dependent on price. As the price fluctuates, so does the yield. It is referred as the interest or dividends received from a security, generally expressed yearly as a percentage based on the investment's cost, its current market value or its face value.

4. Explain Yield to Maturity.

Yield to maturity (YTM) is the most commonly cited type of yield measurement. It measures what is the return on a bond is if it is held to maturity and all coupons are reinvested at the YTM rate. Because it is unlikely that coupons will be reinvested at the same rate, an investor's actual return will differ slightly.

5. What is Normal Yield Curve?

A normal yield curve is upward sloping showing all the yields earned at different duration of the bond. The curve also reflects the fact that a bond with a longer maturity pays a higher yield than the same bond which matures early. Thus, the yield curve majority of its time in the shape of a normal upward sloping curve.

6. How we calculate value of a Bond?

The value of a bond can be calculated through calculation of return from bond as

Return (k) = $\frac{(B1 - B0) + C1}{B0}$

To know the current price from returns we can re-arrange this equation for both current price as well as future price.

$B_0 = \frac{C1 + B1}{1+k}$ $B_1 = \frac{C2 + B2}{1+k}$.

7. What is Holding Yield?

Bond investors are not obligated to take an issuer's bond and hold it until maturity. There is an active secondary market for bonds. This means that someone could buy a 30-year bond that was issued 12 years ago and hold it for five years, then sell it again. The bondholder can substitute the sale price for the par value and change the term to equal the length of the holding period. Hence it is also known as Holding Yield Bond.

8. Explain Humped Yield curve

In a humped yield curve the short and long term rates are closer to each other as compared with medium term rates. It is commonly observed when there is fluctuation observed i.e increase in demand or decrease in supply of longer term bonds.

9. What are the four major yields of Bonds?

The four major yields of bonds are

a) ***coupon*** (the bond interest rate fixed at issuance),
b) ***current*** (the bond interest rate as a percentage of the current price of the bond),
c) ***yield to maturity*** (an estimate of what an investor will receive if the bond is held to its maturity date).
d) ***Non-taxable municipal bonds*** will have a tax-equivalent (TE) yield determined by the investor's tax bracket.

10. Explain Yield Curve.

Yield curves are pictorial representation of time and yield earnings over the period of time. Thus, it shows the relationship between two and gives a comparative picture of

different bonds by plotting maturities and their respective yields from a particular state.