15 Lecture - MGT201

Important Subjective

1. **Define bond valuation and explain the components of a bond's price.**
Answer: Bond valuation refers to the process of determining the fair market value of a bond. The components of a bond's price include the coupon rate, the face value, the maturity date, and the current market interest rate. The price of a bond is calculated by discounting the future cash flows generated by the bond to the present value using the current market interest rate.

2. **What is the yield to maturity of a bond? Explain its importance in bond valuation.**
Answer: The yield to maturity of a bond is the rate of return an investor can expect to receive if they hold the bond until maturity. It is important in bond valuation because it is used to determine the fair market value of a bond. The yield to maturity takes into account the current market price of the bond, the face value, the coupon rate, and the number of years to maturity.

3. **What is meant by the term "bond yield"? How is it calculated?**
Answer: Bond yield refers to the rate of return an investor can expect to receive on a bond. It is calculated by dividing the annual interest payment by the current market price of the bond. The resulting percentage represents the bond yield.

4. **What is the difference between current yield and yield to maturity?**
Answer: The current yield of a bond is the annual income generated by the bond divided by its current market price. It is a simple calculation that does not take into account the time value of money. The yield to maturity, on the other hand, is the rate of return an investor can expect to receive if they hold the bond until maturity. It takes into account the time value of money and factors in the current market price of the bond, the face value, the coupon rate, and the number of years to maturity.

5. **Explain the concept of interest rate risk in relation to bond valuation.**
Answer: Interest rate risk refers to the risk that the value of a bond will decrease as a result of a change in the market interest rate. When the market interest rate increases, the value of existing bonds decreases because the coupon rate on those bonds becomes less attractive to investors. This means that bond prices are inversely related to interest rates. As interest rates rise, bond prices fall, and vice versa.

6. **What is a zero-coupon bond? How is it valued?**
Answer: A zero-coupon bond is a bond that does not pay any interest during its life. Instead, the investor receives the face value of the bond at maturity. Zero-coupon bonds are valued by discounting the face value to the present using the current market interest rate. Since zero-coupon bonds do not pay any interest, their value is highly sensitive to changes in the market interest rate.

7. **How is the yield curve used in bond valuation?**
Answer: The yield curve is a graphical representation of the relationship between bond yields and their respective maturities. The shape of the yield curve is important in bond valuation because it provides information about the current and future state of the economy. A steep yield curve indicates that investors expect interest rates to rise in the future, while a flat yield curve

indicates that interest rates are expected to remain stable.

8. **What is the difference between a callable bond and a putable bond?**
Answer: A callable bond is a bond that allows the issuer to redeem the bond before its maturity date. This means that the investor's cash flows can be interrupted if the bond is called. A putable bond, on the other hand, is a bond that allows the investor to redeem the bond before its maturity date. This means that the investor has the right to sell the bond back to the issuer at a predetermined price.

9. **What is the difference between a premium bond and a discount bond?**
Answer