FIN 366: INVESTMENTS
CRITICAL THINKING & CONCEPTUAL QUESTIONS

Chapter 10:

1. What drives changes in bond prices? In what interest rate environment and in what economic conditions might investors choose to buy bonds?
2. What are some of the reasons why we don't see corporate bond price movements reported as much as stocks in the financial press?
3. When would it be advantageous for an investor to exercise their option to convert a convertible bond?
4. When would it be advantageous for a firm to call a callable bond?
5. When would it be advantageous for an investor to exercise their option to demand early repayment on a puttable bond?
6. When would it be advantageous for an investor to exercise their option to extend the maturity of a puttable bond?
7. What will the price of a bond be if the coupon rate is the same as the bond's yield to maturity? (*Hint:* put FV = 1000, N = 30 in your calculator, and choose a coupon rate and YTM before computing the PV.)
8. When would we expect a bond's coupon rate to be the same as the YTM?
9. Everything else held constant (EEHC), would you expect higher or lower coupons on convertible bonds or non-convertible bonds?
10. EEHC, would you expect a callable bond to be issued with higher or lower coupons than a non-callable bond?
11. EEHC, is a bond's price higher or lower if coupons are higher? What if the discount rate is higher? The par value?
12. EEHC which of the bonds in each of these pairs would you expect to be offered at a lower price, assuming they all pay no coupons?
    a. Puttable vs. Callable
    b. Senior vs. Subordinate
    c. Debenture vs. Collateralized
    d. Speculative vs. Investment Grade

13. Why do bond prices fall when interest rates rise? Don't investors *want* to receive high interest rates?
14. If a bond sells at $900 and its par is $1000, is this a premium or discount bond? What if it sells for $1100 and its par is $1000? Why would a bond sell below or above par in the first place?
15. If a bond has a coupon rate of 9% and a YTM of 10%, is this a premium or discount bond? What if its coupon rate is 11% and the YTM is 10%?
16. We learned about the YTM, yield to call, current yield, and holding period return. When would investors be interested in calculating each? That is, what are some of the things you'd consider when deciding which to calculate and use if you held a bond?
17. Would it make more sense for you to calculate the yield to call on a callable bond you hold if you expect interest rates will *rise* or if you expect interest rates to *fall*?
18. Examine the table below. Which of the feature(s) listed help explain why the Richmond Bonds have a lower coupon rate than the Westhampton Bonds? Which of these feature(s) might make you question why Richmond has lower coupons than Westhampton?

	Richmond	Westhampton
Coupon	8%	12%
Collateral	Firm land and property	None
Callable	Not callable	In 10 years
Puttable	Extendable for 3 years	May not be extended
Credit Rating	BBB+	AA
Senior/Subordinate	Senior	Subordinate

19. If prevailing interest rates change, what happens to the coupon rate of previously issued bonds? What likely happens to the coupon rates of newly issued bonds?
20. The FED announces a surprise cut to interest rates. What might we expect of bond yields on existing debt on this news?
21. You hold a 4% coupon bond maturing in 10 years. You notice that interest rates are beginning to rise. What does this mean for your coupon payments? What happens to the value of your bond?
22. How would you answer a client who says, "This corporate bond I hold is locked into paying me 7% coupons. I get $70 a year for the next 30 years, as

well as $1,000 at maturity. Why should I care what happens to prevailing markets rates? How does this affect me and my bond?"

23. Why would a single firm have multiple credit ratings on its bond issues?
24. For each pair below, choose which one you think is more likely to have the higher credit rating, EEHC:
    a. A firm with leverage significantly above the industry average vs. a firm with leverage significantly below the industry average
    b. A subordinate debt issue vs. a senior debt issue
    c. A secured vs. an unsecured bond issue
    d. An investment grade vs. a speculative grade bond
25. Would you rather be an equity holder or a subordinated debt holder of a firm in the event of that firm's liquidation following bankruptcy?