RAMA UNIVERSITY

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FACULTY OF COMMERCE AND MANAGEMENT

COURSE: BBA (DM)

SUBJECT: SECURITY AND PORTFOLIO MANAGEMENT

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What Is a Bond?

- A bond is a fixed income instrument that represents a loan made by an investor to a borrower (typically corporate or governmental). It is a category of debt that borrowers avail from individual investors for a specified tenure. Bonds are issued by organizations generally for a period of more than one year to raise money

Categories of Bonds

- **Corporate bonds** are issued by companies. Companies issue bonds rather than seek bank loans for debt financing in many cases because bond markets offer more favorable terms and lower interest rates.
- **Municipal bonds** are issued by states and municipalities. Some municipal bonds offer tax-free coupon income for investors.

Categories of Bonds….

- **Government bonds** such as those issued by the U.S. Treasury. Bonds issued by the Treasury with a year or less to maturity are called “Bills”; bonds issued with 1-10 years to maturity are called “notes”; and bonds issued with more than 10 years to maturity are called “bonds”. The entire category of bonds issued by a government treasury is often collectively referred to as "treasuries." Government bonds issued by national governments may be referred to as sovereign debt.
- **Agency bonds** are those issued by government-affiliated organizations such as Fannie Mae or Freddie Mac.

What Is Bond Valuation?

- Bond valuation is a technique for determining the theoretical fair value of a particular bond. Bond valuation includes calculating the present value of a bond's future interest payments, also known as its cash flow, and the bond's value upon maturity, also known as its face value or par value.

Understanding Bond Valuation

- A bond is a debt instrument that provides a steady income stream to the investor in the form of coupon payments. At the maturity date, the full face value of the bond is repaid to the bondholder. The characteristics of a regular bond include:
- **Coupon rate**
- **Maturity date**
- **Current price**

Understanding Bond Valuation….

- **Coupon rate**: Some bonds have an interest rate, also known as the coupon rate, which is paid to bondholders semi-annually. The coupon rate is the fixed return that an investor earns periodically until it matures.
- **Maturity date**: All bonds have maturity dates, some short-term, others long-term. When a bond matures, the bond issuer repays the investor the full face value of the bond. For corporate bonds, the face value of a bond is usually $1,000 and for government bonds, the face value is $10,000. The face value is not necessarily the invested principal or purchase price of the bond.

Understanding Bond Valuation....

- **Current price**: Depending on the level of interest rate in the environment, the investor may purchase a bond at par, below par, or above par. **For example**, if interest rates increase, the value of a bond will decrease since the coupon rate will be lower than the interest rate in the economy. When this occurs, the bond will trade at a discount, that is, below par. However, the bondholder will be paid the full face value of the bond at maturity even though he purchased it for less than the par value.