

EC 247 Financial Instruments and Capital Markets

Class Exercise 4

These questions correspond to chapter 12 of the Frederic S. Mishkin and Stanley G. Eakins, *Financial Markets and Institutions*, 7th Edition, Pearson Prentice Hall, 2012.

Question 1

Contrast investors' use of capital markets with their use of money markets.

Question 2

The yield on a corporate bond is 10% and it is currently selling at par. The marginal tax rate is 20%. A par value municipal bond with a coupon rate of 8.50% is available. Which security is a better buy?

Question 3

If the municipal bond rate is 4.25% and the corporate bond rate is 6.25%, what is the marginal tax rate assuming investors are indifferent between the two bonds?

Question 4

A zero coupon bond has a par value of \$1,000 and matures in 20 years. Investors require a 10% annual return on these bonds. For what price should the bond sell? (note, zero coupon bonds do not pay any interest)

Question 5

A 10-year, 1,000 par value bond with a 5% annual coupon is trading to yield 6%. What is the current yield?

Question 6

A \$1,000 par bond with an annual coupon has only 1 year until maturity. Its current yield is 6.713% and its yield to maturity is 10%. What is the price of the bond?
