Activity Sheet 3: Making Money with Bonds

Bonds are also known as fixed-income investments. The investor knows the rate of interest and the interest payment schedule before buying the bond. Investment grade bonds are an essential part of a diversified portfolio because they have predictable payment streams and a high degree of certainty that the principal (i.e., face or par value) will be repaid.

Investment grade bonds such as U.S Treasury and investment grade corporate and municipal bonds have a very low repayment risk. Many people invest in them to preserve and increase their investment capital or to receive dependable income. Large institutions such as banks, pension funds, insurance companies, and foreign governments also invest in investment grade bonds.

The interest rate of a bond is how you make money when you buy a bond. It is determined by many factors including the length of time the bond takes to mature, the quality and reliability of the issuer, and the risk of early repayment.

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Using the information you know about how an investor makes money with bonds, compute simple interest for the following bonds and decide which you would include in your portfolio.

You are investing **$1000.00**:

1. A treasury bond will pay 3% interest a year for 30 years. How much interest will the investor collect each year? How much interest will the investor collect at the end of 30 years?

2. A municipal bond will pay 4% interest a year for 10 years. How much interest will you collect in one year? How much interest will the investor collect in 10 years?

3. A corporate bond will pay 6% interest each year for 2 years. How much interest will you collect?

4. Which investment would you most recommend to your SMG team? Why?

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You are investing **$3000.00**:

5. The Ginnie Mae Corp issues a five year bond at 3% interest. How much money will you have after the bond matures? (Face value+ interest for 5 years= maturity rate)

6. A treasury bill has a 9% interest rate for 27 weeks. How much will you have collected after the bill matures?

7. A corporate bond will be issued for one year at a 6% interest rate. How much interest will you make on your investment?

8. Which investment would you most recommend to your SMG team? Why?

You are investing **$5000.00**:

9. A city government is issuing a bond for 20 years at 3.5%, how much interest will you collect when the bond matures?

10. A large corporation is issuing a 1-year bond at 6.3%, how much money will you have collected after the bond matures?

11. The treasury department is issuing a 20-year bond at 4.5%, how much money will you have collected after the bond matures?

12. Which investment would you most recommend to your SMG team? Why?

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