

# Activity Sheet 1: About Bonds

## Part 1: What is a Bond?

Bonds are issued by corporations, governments and government agencies to raise large amounts of money. Just like any loan, the issuer, or organization trying to sell the bond, agrees to pay back the money borrowed on a set date and agrees to pay interest. Interest is money paid by the lender to the borrower in addition to the amount borrowed for use of the money.

Investors buy investment grade bonds because they are considered very safe investments. They are issued by corporations and governments who are considered very trustworthy. These issuers always pay the interest and the loan back when they promise; Bonds can take anytime from a few weeks to thirty years to mature. Of course, just like a friend can refuse or be unable to pay all or part of an IOU an issuer can refuse or default on a bond but it is unlikely this will happen when you buy investment grade bonds. Today we will learn about the safest kind of bonds. Investment grade bonds are the most likely to be repaid on time. Let's look at an example:

You buy a U.S. Government 10-year Treasury bond on the day it is issued -- let's say January 1st and the bond has a \$1000 face (or par) value. This means you have given our federal government a 10-year loan, which means that on December 31 ten years from now, Uncle Sam will write you a check for \$1000 to repay the loan. Let's also assume that your 10-year Treasury bond had an interest rate (or coupon rate) of 5 percent, the government will also pay you \$50 per year over the 10-year life of the bond for the privilege of using your money. Interest on most bonds does not compound.

1. How is a bond like an IOU?
2. Why is an investment grade bond is considered a "safe" investment?
3. How can an investor make money by buying a bond?
4. Would you recommend your Stock Market Game team include a bond in your portfolio? Why, why not?



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## Part 2: KINDS OF BONDS

The chart below describes the four most common types of Bonds. Use the chart to answer the questions

CORPORATE	MUNICIPAL
Bonds are major sources of corporate borrowing. The most common type of corporate bond are backed by the general credit of the corporation. Asset-backed bonds are backed by specific corporate assets, such as property or equipment.	Millions of bonds have been issued by state and local governments. General obligation bonds are backed by the full faith and credit of the issuer. Revenue bonds are backed by the income generated by the particular project it financed.
AGENCY	US TREASURY
Some government sponsored but privately-owned corporations (like Fannie Mae and Freddie Mac) and certain federal government agencies (like Ginnie Mae and Tennessee Valley Authority) issue bonds to raise funds either to make loan money available or to pay off new projects.	Treasury notes are an intermediate-term obligation of the U.S. Treasury. They have a maturity period of one to 10 years and pay interest semiannually. Bills, are short-term obligations of the U.S. Treasury. They have a maturity period of one year or less and are sold at a discount from face value.

1. The local governments want to build a new bridge to connect two parts of a growing city. Which type of bond would a local government issue? Why?
2. A home mortgage company backed by the government wants to raise money for more first-time home mortgage loans. Which type of bond would the government sponsored agency issue? Why?
3. An investor wants to make the safest possible bond investment and plan to collect the interest for ten years. Which type of bond should the investor purchase? Why?



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4. A large corporation wants to expand into Asian markets. They want to issue a bond and plan to guarantee the bond with land holdings in Latin America so What type of bond would they issue? Why?
  
5. A major corporation wants to issue a bond; they have a reputation for being a trustworthy company. They want to use their credit rating to guarantee the bond. What type of bond would they issue? Why?
  
6. An investor wants to support the increase of water power in America and would like to purchase a bond from the Tennessee Valley Authority. What type of bond would he purchase? Why?



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