1. Your brother-in-law tells you at a family picnic that investors in the A-Fund, the bond fund that he manages, have been lucky; they now have a current yield on their portfolio of 20%. At the same time the current yield on the Safe-Fund, a competitor, is 10%. Should you join the ranks of A-Fund investors? Why or why not?

2. Suppose that you are considering the purchase of a coupon bond that has the following future payments: $600 in one year, $600 in two year, $600 in three year, and $600 + $10000 in four years.

   (a) What is the bond worth today if the market interest rate is 6%? What is the bond’s current yield?

   (b) Suppose that you have just purchased the bond, and suddenly the market interest rate falls to 5% for the foreseeable future. What is the bond worth now? What is the current yield now?

   (c) Suppose that one year has elapsed since you bought the bond, and you have received the first coupon payments of $600, and the market interest rate is still 5%. How much would another investor be willing to pay for your bond? What was your total return on the bond? If another investor had bought the bond a year ago for the amount you calculated in (b), what would that investor’s total return have been?

3. Hitechco, a relatively young technology company, has $10 million in bonds outstanding. You notice in the Wall Street Journal that the firm has been awarded a $30 million settlement in a patent with an electronics conglomerate. What would you predict to be the effect of the settlement on the yield on and the price of Hitechco’s bonds?

4. How would each of the following events affect the interest rate?

   (a) A natural disaster destroys bridges and roads in Kocaeli, leading to increased investment spending to rebuild.

   (b) Future taxes of businesses are expected to be increased.

   (c) The government proposes a new tax on savings, based on people’s balances on December 31st each year.