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Chapter 19: Bonds and Mutual Funds

Check Your Answers: Section Assessment

Section 1

Review Key Concepts
1. Debentures—bonds that are backed by the corporation's reputation; mortgage bonds—bonds that are backed by the corporation's assets; subordinated debentures—unsecured bonds that give bondholders a claim to interest payments and assets; convertible bonds—bonds that an investor can trade for shares of the corporation's common stock.

2. A company might issue corporate bonds in order to finance regular business activities; raise money when it is difficult to sell stock; reduce the taxes it pays.

3. Investors buy corporate bonds because many are safeinvestments; bonds may help diversify an investment portfolio; most bonds provide interest income; and bonds may increase in value.

4. The government sells bonds and other securities to help finance regular services and the national debt.

5. A general obligation bond is a bond that is backed by the full faith and credit of the government. A revenue bond is a bond that is repaid from the income generated by the project it finances.

Higher Order Thinking
6. The investor must be compensated for taking the risk that the bond issuer will call the bond if interest rates decline, which would force the investor to reinvest the proceeds at lower yields.

English Language Arts
7. Personal Goals and the Community Answers will vary. Students may suggest that Saundra buy the bonds because they are virtually risk-free and have a chance to increase the financial stability of her community. Others may say that she should invest her money in other ways to increase her personal return. Some students may say that she compromise and invest her money in bonds as well as other securities.

Mathematics
8. Bond Market Value Total interest earned each year = $2,000 × 7.5% = $150.00 per bond or $150.00 × 2 = $300.00 total; Julian's bonds increased in value. Since the interest rate on comparable bonds decreased, Julian's bonds earn more interest than these new bonds, therefore their value increases; Approximate market value = $150.00/6.75% = $2,222.22 per bond or $2,222.22 × 2 = $4,444.44 total