CHAPTER 1: FIXED INCOME VALUATION

LESSON 2: PRICE VOLATILITY

Question 1

Correct answer: C

The statement made by Kormack is correct. If a bond is trading at par then investors require a return equal to the bond's coupon rate (5.8%). If the required rate of return were to increase by 50 bps (to 6.3%), the bond price would change to €952.38 which represents a drop of €47.62:

N	I/Y	CPT PV	PMT	FV
15	6.3	-952.38	58	1,000

Fitch is correct in stating that a 50 bps fall in the required rate of return (to 5.3%) would cause the bond price to increase but she is incorrect with regard to the new price level:

N	I/Y	CPT PV	PMT	FV
15	5.3	-1,050.86	58	1,000

Question 2

Correct answer: A

Compared with bond X, bond Y will experience a lower percentage price change as bonds with higher coupons exhibit less price sensitivity in response to interest rate fluctuations (all other things equal).

Question 3

Correct answer: A

Compared with bond Z, bond Y will experience a lower percentage price change as bonds with shorter maturities exhibit less price sensitivity in response to interest rate fluctuations (all other things equal).