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Class _____

Teacher _____

CHAPTER 10 Bonds and Mutual Funds

Reviewing Key Terms: Complete the Sentence



DIRECTIONS: Using terms from the following list, complete the sentences below. Write the letter of the item you have chosen in the space provided.

- | | | |
|---------------------|---------------------------|--------------------------|
| A. mortgage bond | D. municipal bond | G. net asset value (NAV) |
| B. serial bonds | E. investment-grade bonds | H. no-load fund |
| C. zero-coupon bond | F. closed-end fund | I. income dividends |
| | | J. face value |

- _____ is a bond that provides no interest payments.
- The earnings a fund pays to shareholders are _____.
- Companies or municipalities with good financial stability issue _____.
- A(n) _____ is a security issued by a state or local government to pay for its ongoing activities.
- The assets of a corporation are used to back a(n) _____.
- The amount one share of a mutual fund is worth is called its _____.
- A mutual fund with no commission fee is a(n) _____.
- _____ are bonds issued at the same time but which mature on different dates.
- The _____ is the dollar amount that the bondholder will receive at the bond's maturity.
- A(n) _____ has a fixed number of shares that are issued by an investment company when the fund is first organized.

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Understanding Key Concepts



DIRECTIONS: On a separate sheet of paper, answer the following questions.

1. What information is typically on a corporate bond?
2. Why do investors buy debenture bonds?
3. Why do investors who buy subordinated debentures usually receive higher interest rates than other bondholders?
4. Why is the interest rate on a convertible bond often lower than that on other types of corporate bonds?
5. How does a call feature benefit a corporation?
6. Perry bought bonds that the corporation is now calling. Where can Perry look to find the amount of the premium the corporation agreed to pay in case of a call?
7. Ben and Jill want to purchase bonds to finance their toddler's college education. Which kind would you recommend: Treasury bonds or bonds issued by Fannie Mae? Explain your answer.
8. Stella is looking for a safe investment that will provide a predictable source of income. She consults the *Moody Bond Survey* and finds the names of two corporations in which she would like to invest. One is rated B and the other Baa. Which investment will probably best meet her needs? Why?
9. How does an aggressive growth fund differ from an equity income fund?
10. Emilio wants to buy shares in an open-end mutual fund and do so in the simplest way possible. Which option would you recommend: a regular account transaction, a savings plan, or a reinvestment plan? Why?

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Activity 1: *Creating a Checklist for Evaluating a Bond*



SKILLS ACHIEVED

Reading, Writing, Math, Acquiring and evaluating information, Organizing and maintaining information, Interpreting and communicating information, Teaching others

OBJECTIVE: Prepare a checklist to use to evaluate a bond investment.

Imagine you saved \$1,000 and wanted to invest it in some kind of bond. What would you need to know to make a wise investment? In this activity you will prepare a checklist of elements that you would need to examine in order to evaluate the return, risk, and suitability of a particular bond. Then you will exchange checklists with a partner and use your partner's checklist to evaluate an actual bond.

Use the space below to make notes. Then, on a separate sheet of paper, create a checklist of elements that should be examined when evaluating a bond. Make sure you leave enough space for the answers. Exchange checklists with a partner. Finally, choose a specific corporate, municipal, or Treasury bond; look it up in one of the sources listed in Chapter 10; and fill in your partner's checklist with information from the source.

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Activity 2: Analyzing Mutual Funds



SKILLS ACHIEVED

Reading, Writing, Problem solving, Decision making, Reasoning, Acquiring and evaluating information, Interpreting and communicating information, Organizing and maintaining information, Selecting technology, Applying technology to task

OBJECTIVE: Obtain information about three mutual funds, analyze the information, and profile a suitable investor for one of the funds.

The revolution in computer technology and the Internet have placed a vast amount of up-to-the-minute information at the fingertips of anyone with a computer and a modem. This especially benefits investors in mutual funds. In this activity, you will choose three mutual funds to evaluate. Then you will write a short profile of the ideal investor in one of the funds you evaluated.

First, choose three different mutual funds with different focuses (for example, a large-cap growth fund, a small-cap fund, and an international fund). Then check financial publications at the library, a financial Web site, or the company Web sites. You could also check a newspaper that features a mutual fund section. Enter information about the funds in the chart on the next page. Finally, based on the data you obtain—as well as what you have learned in the text about risk, investment objectives, and financial goal setting—write a short description of the kind of investor you feel is suitable for one of the funds you have investigated.

Investor Profile for:

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Fund name			
Family			
Type/Objective			
Charges (if any)			
Current NAV			
Major holdings			
Return			
1-year return			
3-year return			
5-year return			
Other data			

CHAPTER 10 Bonds and Mutual Funds

Math-Building Skills: Many Happy Returns



A key to being an intelligent investor is knowing how well your investments are doing. Part of this knowledge is the total return over several time periods. In this activity, you will use your math skills to determine the one-, two-, three-, and five-year total returns for a mutual fund investment.

The total return for a selected period is determined by subtracting the net asset value listed for the period from the current value, then dividing the difference by the net asset value of the period. For example, suppose that the current net asset value is \$46.98, and one year ago it was \$42.46. To find the one-year total return, subtract \$42.46 from \$46.98. The result is \$4.52. Divide \$4.52 by \$42.46. The total return for the one-year period is 10.6 percent.

To find the average annual return for two or more years, divide the percentage gain or loss by the number of years in the period. The average annual return for the one-year period would be 10.6 (the percentage gain) divided by 1 (the number of years in the period), so the answer would be 10.6 percent. Do not forget to adjust your figures for negative numbers, which result in years when funds have losses.

DIRECTIONS: The following chart shows some financial data for the New Directions Small-Cap Discovery Fund. Use the data shown to determine the total returns for the periods listed. Use the space below the chart for your computations. Round percentages up to nearest decimal point.

Period	Net Asset Value (NAV)	Total Return for Period	Average Annual Return for Period
Current	\$46.98	—	—
1 year ago	\$42.46	10.6%	10.6%
2 years ago	\$38.90	_____	_____
3 years ago	\$45.92	_____	_____
5 years ago	\$31.67	_____	_____

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Finance Online: Fund Ratings



Ratings for mutual funds are provided by services such as Standard & Poor's; Lipper Analytical Services; Morningstar, Inc.; Value Line; and Wiesenberger Investment Companies. A mutual fund rating shows how a fund performed in relation to other mutual funds in the same category. These services also provide other information about mutual funds. Some provide graphs to show the growth or list the annual returns in chart form. They might list the holdings of each fund, the manager of the fund, the minimum investment, sales charges, and long-term performance.

Use the Internet to find the names of four specific funds and how they are rated. Use one of the major rating services as a keyword. Go to a Web site that gives fund ratings. Use the information you find to answer the questions below.

Keywords Used	Site Names	Web-Site Addresses	Information Offered

1. In addition to ratings, what other information does the site provide about the mutual fund?

2. List the names of four funds with different ratings. Write the rating after each fund.

3. Of the four funds you listed, which would you most likely invest in? Explain your reasoning.

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Your Financial Portfolio Worksheet

Evaluating Mutual Funds

Because a mutual fund can sometimes earn a higher return than a CD, you might want to invest your money in a mutual fund someday. Doing your research before you invest can help you make a wise choice. Practice researching mutual funds by picking one of the following:

- Fidelity Latin America
- AIM Blue Chip Fund Class A
- Your own choice

Then call the investment company for a prospectus of the mutual fund that you have chosen. You can also check the Morningstar Web site or find *Morningstar Mutual Funds* at your local library. Fill in the information on the checklist below to evaluate the fund.

Comparing Mutual Funds

1. Name of mutual fund _____
2. Mutual fund type (stock, bond, futures, money market, balanced, indexed, sector, etc.) _____
3. Mutual fund objective (aggressive growth, moderate growth, income and safety, or income) _____
4. Number of securities in fund's portfolio _____
5. Types of industries in fund's portfolio _____
6. Yield in the last 12 months _____
7. Average return or yield for the last 5 years _____
8. Average return or yield for the last 10 years _____
9. Fees: load, 12b-1 fee, annual management fee _____
10. What is the minimum investment? _____
11. Is the fund closed to new investors? _____
12. Morningstar rating (in stars and risk) _____

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CHAPTER 10 Bonds and Mutual Funds

**Software
Activity
(Optional)**

Spreadsheet Application

Calculating Profit or Loss on a Bond Transaction



OBJECTIVE: Calculate the profit or loss realized on a bond transaction.

Practice Situation

Assume that you purchased an 8 $\frac{3}{8}$ percent Phoenix Municipal Water Bond on December 1, 2000. You paid \$650 plus a \$25 commission charge, for a total investment of \$675. The bond holds a maturity date of 2020. On December 1, 2010, you sold the bond at its current market value of \$1,050. Complete the spreadsheet to determine the total profit or loss on the bond transaction. Then, answer the questions that follow.

Purchase Costs	
1 bond @ \$650	
Plus commission cost	
Total investment	

Returns when Sold	
1 bond @ \$1,050	
Minus commission fee	
Total return on sale	

Transaction Summary	
Total return on sale	
Minus total investment	
Profit from bond sale	
Plus interest	
Total profit and interest on transaction	

Spreadsheet Directions

1. Start your spreadsheet software program and open problem SA10.xls.
2. Using the data presented, first input the purchase costs for the bond. *Note: Format all dollar amounts to Number, 2 decimal places. Use 1000 Separator (,).*
3. Next, input the data for the dollar returns on the sale of the bond.
4. Complete the transaction summary information. When computing the interest on the bond, remember to multiply the annual interest earned by the number of years that the bond has been held.
5. When you have completed your spreadsheet, save your work to a new file labeled SA10***.xls. (Replace *** with your initials.)
6. Print out a copy of your work if your teacher has instructed you to do so.

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Interpreting Results

1. What was your total investment for the bond on December 1, 2006?

2. What were the total dollar returns on the sale of the bond on December 1, 2016?

3. What total interest income was earned on the bond for the period of 12/1/2006 through 12/1/2016?

4. What total profit and interest was earned on the bond transaction?

Drawing Conclusions

1. In this example, the Phoenix Municipal Water bond was sold well in advance of its maturity date. If the bond had been held until its maturity date, what total interest would have been earned over the life of the bond?

2. What factors might cause an investor to sell a bond prior to its maturity date? How might fluctuations in the overall interest rates of the economy impact bond market values? Explain.

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SELF-ASSESSMENT QUIZ

DIRECTIONS: Identify the letter of the choice that best completes the statement or best answers the question.

1. The face value of a bond is the amount a bondholder (A) pays for the bond (B) receives at maturity (C) receives in interest (D) loses if the corporation fails.
2. Assets of a corporation may be sold to repay a (A) mortgage bond (B) debenture (C) convertible bond (D) bond indenture.
3. An additional amount that a company pays above the value of its bond is called (A) a sinking fund (B) a coupon (C) a premium (D) an interest check.
4. Only the bond owner can collect interest from a (A) registered bond (B) registered coupon bond (C) bearer bond (D) zero-coupon bond.
5. Which investment offers the highest rate of interest? (A) Treasury bill (B) Treasury bond (C) Series EE Savings Bond (D) agency bond
6. Municipal bonds are offered by all the following levels of government *except* (A) federal (B) state (C) county (D) city.
7. The lowest Standard & Poor's rating a bond can have and still be considered investment grade is (A) B (B) BB (C) BBB (D) C.
8. How do you find the current yield of a bond? (A) Divide the bond's current market value by the amount of annual interest income. (B) Divide the amount of annual interest income by the bond's current market value. (C) Multiply the face value times the annual rate of interest. (D) Multiply the face value times the rate of return.
9. A back-end load on a mutual fund is charged for (A) each purchase of shares (B) managing the mutual fund (C) marketing and advertising the fund (D) withdrawing money from the fund.
10. Investors pay penalty fees if they fail to make regular purchases of shares when investing in a mutual fund under a (A) regular account transaction (B) voluntary savings plan (C) contractual savings plan (D) reinvestment plan.