

FIN101 Fixed Income I Questions – Set I Part C
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Question 41: I) An option-free bond has positive convexity over the entire range of yields.

II) An callable bond has negative convexity over some entire range of low yields.

I&II are: A) FT B) FF C) TT D) TF

Question 42: A bond has a price of \$973.22 and a duration of 7.94 years. The price value of a basis point is:

A) \$0.7627

B) \$0.7727

C) \$0.7827

D) \$0.7927

Question 43: I) Bonds issued by US Government Sponsored Entities are backed by full faith and credit of the US government.

II) Municipal bonds in the US may be tax-advantaged.

I&II are: A) FT B) FF C) TT D) TF

Question 44: Consider a TIPS with a face value of \$1,000 and annual coupon of 5%. Suppose during the first six months inflation is 4% (annualized 8%). Then at the end of the six months, the face value of the TIPS will be increased to:

A) \$1,025

B) \$1,040

C) \$1,050

D) \$1,080

Question 45: I) STRIPS are zero coupons formed by stripping coupons from AAA Corporate bonds.

II) Most recently issued Treasury securities are called on-the-run Treasury securities.

I&II are: A) FT B) FF C) TT D) TF

Question 46: I) General Obligation (GO) are backed by all revenues (full faith) of the issuing municipality.

II) Revenue Bonds have lower yields compared to GO bonds.

I&II are: A) FT B) FF C) TT D) TF

Question 47: I) Pre-refunded bonds have low default risk as they have Treasuries as collateral.

II) A Muni may be insured by a third party, in which case it is called an Insured Bond.

I&II are: A) FT B) FF C) TT D) TF

Question 48: I) Commercial Paper is long maturity corporate debt.

II) MBS payments are backed by the principal and interest payments of a pool of corporate debt.

I&II are: A) FT B) FF C) TT D) TF

Question 49: I) CMOs are derivative securities of MBS, and are designed to reduce prepayment risk by breaking up the cash flow into tranches.

II) All CMO tranches have equal risk.

I&II are: A) FT B) FF C) TT D) TF

Question 50: I) Once an MTN has been approved by the SEC, the corporation can sell the bonds whenever they wish.

II) MTNs with payments dependent upon other underlying assets/indices are called Structured Notes.

I&II are: A) FT B) FF C) TT D) TF

Question 51: I) Structured Notes enable institutional investors to participate in markets otherwise forbidden to them.

II) A SPV is an entity set up by a firm with the objective of raising debt at a lower cost.

I&II are: A) FT B) FF C) TT D) TF

Question 52: I) A firm can have “credit enhancement internally” by obtaining insurance from third parties.

II) A CDO is a debt product backed primarily by residential mortgages.

I&II are: A) FT B) FF C) TT D) TF

Question 53: I) The collateral for a CLO is commercial mortgages.

II) The collateral for a CBO is bonds.

I&II are: A) FT B) FF C) TT D) TF

Question 54: I) Foreign Bond is a bond issued in the home country by a foreign issuers.

II) Examples of foreign bonds are Dixie, Toro, Gauguin, Spaniel, Geisha etc.

I&II are: A) FT B) FF C) TT D) TF

Question 55: I) Longer duration bonds have lower Interest Rate Risk.

II) Interest Rate Risk is the risk due to changes in price of bonds due to changes in market interest rates.

I&II are: A) FT B) FF C) TT D) TF

Question 56: I) A bond with an embedded call option will have lower interest rate risk at lower yields.

II) Floating rate bonds have higher interest rate risks.

I&II are: A) FT B) FF C) TT D) TF

Question 57: I) Prepayment Risk for mortgage backed or asset backed securities is due to lenders calling the debt.

II) Yield Curve Risk is due to the differing price changes of a bond to non-parallel shifts in the yield curve.

I&II are: A) FT B) FF C) TT D) TF

Question 58: I) Reinvestment Risk is the risk that the buyer of a bond may not be able to reinvest cash flows from the bond (coupons or principal repayments) at the time of purchase yield.

II) Zero coupons have no reinvestment risk.

I&II are: A) FT B) FF C) TT D) TF

Question 59: I) Inflation Risk is due to changes in face value of bonds as interest rates change.

II) Volatility Risk for bonds with embedded options occurs due to the value of the embedded options changing with change in volatility.

I&II are: A) FT B) FF C) TT D) TF

Question 60: I) Credit risk is due to changes in bond value due to changes in credit spread.

II) Liquidity Risk is a major source of risk for investors who intend to hold the bonds till maturity.

I&II are: A) FT B) FF C) TT D) TF

Question 61: I) A downgrade by a credit rating agency will widen the credit spread.

II) Natural disasters such as floods contribute to Event Risk.

I&II are: A) FT B) FF C) TT D) TF

Question 62: I) The two primary methods by which the FED influences interest rates are Open Market Operations and Changing the Discount Rate by which the FED loans money through its Discount Window.

II) The sale of Treasuries increases demand for bonds, pushing down the interest rate.

I&II are: A) FT B) FF C) TT D) TF

Answers:

41) C 52) B
42) B 53) A
43) A 54) D
44) B 55) A
45) A 56) D
46) D 57) A
47) C 58) C
48) B 59) A
49) D 60) D
50) C 61) C
51) C 62) D

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