**Fixed Income Problem Set**

Fall 2019

Please turn in a hard copy of your answers for all seven problems, along with your calculations for problems 1-6 at the start of class on the due date. Please email a single Excel Spreadsheet with your calculations for problem 7 to me at wreese@tulane.edu . Please title your Excel spreadsheet “Smith, John Fixed Income” with your last name substituted for “Smith” and your first name substituted for “John”. For problems 1, 3, 4 and 6, please carry out your final answers **four decimal places**.

1. You observe the following yields (YTMs) for Treasuries maturing at the following times:

|  |  |
| --- | --- |
| **Maturity** | **Yield** |
| 6 months | 1.50% |
| 1 year | 1.75% |
| 1.5 years | 1.82% |
| 2 years | 2.25% |
| 2.5 years | 2.30% |
| 3 years | 2.32% |
| 3.5 years | 2.50% |
| 4 years | 2.61% |

1. What is the implied six-month forward rate one year from now? **2f3 = 1.9601%**
2. What is the implied six-month forward rate three years from now? **6f7 = 3.5834%**
3. What is the implied one-year forward rate one year from now? **2f4 = 2.7512%**
4. What is the implied one-year forward rate two years from now? **4f6 = 2.4601%**
5. What is the implied one-year forward rate three years from now? **6f8 = 3.4825%**

For A-E above, please express your answers as an annual (BEY) rate.

1. Find the interest payment you would have received (in dollars and cents) on July 15, 2019 if you owned a 10-year TIPS bond which was issued on Jan. 15, 2018 with a face value of $100,000 and a coupon rate of 2.20%. The annual inflation rate is announced at the end of each quarter (end of March, June, Sept. and Dec.). In 2017 the numbers were 1.4%, 1.5%, 1.6% and 1.6%. For 2018 they were 1.6%, 1.7%, 1.8%, and 1.9%. For 2019 they were 1.9%, 1.9%, and 2.0% (The December 2019 rate hasn’t come out yet). For this problem, anytime there appears to be more than one inflation rate you could use, you should use the most recently reported rate. **$1,130.53**
2. Find the YTM of a Treasury bond which you are considering purchasing. The settlement date is Oct. 24, 2019. The bond matures on Dec. 15, 2022 and has a 3.5% coupon rate (the maturity date tells you when the coupon payments are made). The quoted price for the bond is 102:09. **2.7365%**
3. Find the BEY of a Treasury Strip that you can purchase for settlement on Oct. 24, 2019 at a quoted price of 89. The Strip matures on May 15, 2025.  **2.1070%**
4. Price an 8-yr. zero-coupon bond so that it has the same yield as a 2.50% coupon bond which matures at the same time and is currently priced at 101:10 (ignore accrued interest). **83.15**
5. If a Treasury bill has a BEY of 2.00% and it matures in 100 days, calculate its
6. Price **99.4550**
7. Yield on a Discount Basis **1.9619%**
8. Effective Annual Rate **2.0146%**
9. Bond dealers often finance their positions through the repo market. Since repos are very short-term (usually no more than a few days) collateralized loans, the interest paid on the repo is usually less than the interest earned on the bond that is being carried (when the yield curve is upward sloping). This allows the bond dealer to earn profits on (1) the spread, (2) any appreciation of the bond while it is owned, and (3) the carry. Note though, that there is risk to holding a bond.

Here is price data for a 3 ½ % Treasury bond with a maturity date of May 15, 2029, along with the repo rates, for a week in October, 2019.

|  |  |  |
| --- | --- | --- |
|  | **Posted Treasury Quotes** | **Overnight Repo Rates** |
| **Date** | **Bid** | **Ask** | **APR** |
| 10/14/19 | 101:20 | 101:22 |  1.30% |
| 10/15/19 | 101:18 | 101:20 | 1.32 |
| 10/16/19 | 100:25 | 100:27 | 1.38 |
| 10/17/19 | 100:12 | 100:14 | 1.40 |
| 10/18/19 | 100:08 | 100:10 | 1.43 |

Assume that on Monday October 14, an insurance company contacted you, a bond dealer, and sold you $100 million (face value) of the 3 ½ % 5/15/29 T-Bond at your quoted price. You carried the position in the repo market (one day at a time) for four days at a haircut of 0.5% before being contacted Friday morning by a pension plan that purchased the bond from you at your quoted price. For simplicity, assume that settlement occurs on the transaction dates. Calculate the following using dollars and cents (**NOT** percentages of face value):

1. The invoice price of the bond when you purchased it **$103,070,652.17**
2. The invoice price of the bond when you sold it **$101,796,195.65**
3. How much interest you earned for the time you held the bond **$38,043.48**
4. How much interest you paid on the Repo (you pay the entire amount when you receive the bond back – it is not paid each day – so consider compounding) **$15,384.16**
5. The net gain or loss on the round-trip transaction **-$1,289,840.68**