

Bonds

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CLIENT 12th November ANALYSIS AND RECOMMENDATION OF APPROPRIATE BOND TO INVEST IN The 000 Par WMT 3% maturing 2028, priced to yield 4% has a higher price volatility compared to 1, 000 Par TGT 6% maturing 2028, priced to yield 3%. Several factors affect the price volatility of a bond including interest rates, yield and bond duration. Lower interest rates imply higher volatility of the price of a bond. Higher bond durations also lead to high price volatility. When considering the yield of a bond, the higher the yield the lower the price volatility. From the given values, WTM bonds have lower interest rates and longer durations compared to TGT bonds. On yield, even though TGT bonds have a lower yield rate that would result in higher price volatility, the difference of 1% is not significant enough to overshadow the other factors. WTM bonds therefore have higher price volatility.

The duration based estimate of return is different from the actual return calculated based on expected price changes because of the following reasons. First, the duration-based approach views the entire duration of the bond from a given point in time. Given that the bonds earn interest at different rates, the durations for the bonds are also different and are less than their terms respectively. Also, when durations are considered, bond prices are affected hence resulting in different interest rates of return.

Changes in prices, which are imminent in this case, are also not taken into consideration in the former case contributing to the difference.

I think the interest rate for WMT bonds are going to fall over the next year. This is because of lower interest rates and longer duration that would result into lesser demand for the bonds hence a reduction in prices. However, I expect the TGT bond prices to rise because of higher interest rates and shorter durations.

Below is a table showing the calculated values

I would therefore recommend the WMT bonds since over the next year their prices will rise and you can sell them for a greater price than you will buy them and at the same time get higher interest over the period.

Works cited

Investors, American. " AAll: The American Association of Individual Investors." Aaii. com, 2013. Web. 9 Dec 2013. .