Caselet #8 – Sparky Finds a Long First Coupon and Displays Cash Flows

Learning Outcome Statement

After completing this caselet, students and trainees should be able to search for bonds with long (or short) first coupons, display their cashflows and price them correctly using Yield Book Add-in and Excel.

Caselet #8

Ms. Jane Gotzrox, calls her intern into her office for more skills building.

“Sparky,” she says, “you know your bond calculator and Excel spreadsheets, without some fancy searching, aren’t always useful in pricing a bond. This is particularly true for new issues. The reason is that some bonds have ‘long first coupons’ and others have ‘short first coupons.’ Today, long first coupons are more common. They arise from having the dated date being off-cycle from the coupon and maturity dates.”

“I want you to find one. Open a Security Search in Yield Book Add-in. Make the coupon rate a range from 1% to 2% above the coupon of the current on-the-run 10-year (you will have to look that up). Make the maturity date ten years from now, using the year only, and make the Moody’s credit rating a range from Baa1 to Baa3. Only look at Security Type equals Bond and US currency and country. A fair number of bonds should show up.”

“Copy everything from the search box and paste it in a scratch workspace. Then, subtract the Dated Date from the First Coupon Date. Now, it is a simple matter of finding a long first coupon; you can figure out how to identify it.”

“Now, after you’ve found the bond with a long first coupon, I want you to list its first 6 cash flows, using Yield Book Add-in’s Cash Flow function. Make two columns, one with coupon dates and one with interest payments (that’s a hint).”

“Finally, I want you to price the bond in Yield Book Add-in and in Excel. Make the yield for both 25bp below the coupon rate and show me both the clean and dirty prices. If you read through the Financial functions, you can figure out the easy way to price the bond in Excel. As always, make your outputs suitable for inclusion in your interview notebook.”