

Read the text and choose the correct answers.

Bonds are loans raised by national and local governments and companies to finance expenditure or investment. Government bonds, which can last up to 30 years or more, are known as Treasury notes and Treasury bonds in the USA and Treasury stock, gilt-edged stock or just 'gilts' in Britain.

Large corporate borrowers find it cheaper to borrow directly by issuing bonds (usually underwritten by an investment bank) than to borrow from a commercial bank. The buyers of bonds lend money to the issuer, and generally receive fixed, six-monthly or annual interest payments (the bond's 'coupon'). The borrowed money (or principal) is repaid on a given maturity date, usually after 5 to 10 years.

Corporate bonds are generally considered to be safer than stocks, because a company that cannot repay its debts can be declared bankrupt, and have its assets sold to repay creditors, including bondholders. However, a company's financial situation can change during the life of a bond.

Furthermore, on average, stocks pay a higher return than bonds over the medium or long term. Issuers are given credit ratings by credit rating agencies. The highest grade AAA means that there is virtually no risk of default; lower grades for example AA, BBB, BB, B+, and so on indicate progressively greater degrees of risk that the borrower will not be able to repay. Governments and companies with higher credit ratings can borrow at lower rates.

For companies, debt financing (issuing bonds) has an advantage over equity financing (issuing stocks) in that bond interest is tax deductible: companies deduct their interest payments from their profits before paying tax, whereas dividends paid to stockholders come from already-taxed profits. On the other hand, debt has to be repaid, unlike equities which do not, and unlike dividends, bond interest has to be paid, even in a year without any profits to deduct it from.

Bonds are traded on the secondary market by banks and brokerage companies which act as market-makers on behalf of their customers. Bond traders make a market with a bid price at which they buy and an offer price at which they sell, with a very small spread between them. The price of bonds on the secondary market includes accrued interest.

The price of bonds varies inversely with interest rates. If interest rates rise, so new bond issues pay a higher rate, existing bonds lose value, and sell for less than their nominal value (below par). Conversely, if interest rates fall, existing bonds paying more than the market rate will logically increase in value, and trade above par. Therefore the yield of a bond depends on both its purchase price and its coupon.

1. What is the primary purpose of bonds issued by governments and companies?
 - a) To raise funds for expenses or investments
 - b) To attract stockholders for long-term profits
 - c) To compete with other financial products
 - d) To secure tax deductions for investors
2. Why might a company choose to issue bonds instead of borrowing from a bank?
 - a) Bonds are less regulated than bank loans.
 - b) Bonds usually come with lower interest rates than bank loans.
 - c) Banks no longer lend to corporations.
 - d) Bonds do not need to be repaid.
3. How do bondholders typically earn money from their investment?
 - a) By selling bonds above their face value
 - b) By trading bonds on the stock market for dividends
 - c) Through annual tax deductions
 - d) Through regular interest payments and the return of the initial amount

4. What makes bonds generally less risky than stocks?
 - a) They offer higher returns than stocks over time.
 - b) Bondholders have priority in repayment if a company goes bankrupt.
 - c) Bonds are unaffected by market fluctuations.
 - d) They are issued exclusively by government entities.
5. What happens to the value of existing bonds when interest rates increase?
 - a) The value of bonds remains unchanged.
 - b) The value of bonds increases above their face value.
 - c) The value of bonds decreases below their face value.
 - d) The value of bonds is unaffected by market trends.
6. Why might companies with excellent credit ratings have an advantage in issuing bonds?
 - a) They are exempt from repaying the borrowed amount.
 - b) They can issue bonds with shorter repayment terms.
 - c) They are able to secure lower interest rates for their bonds.
 - d) They attract only high-risk investors.
7. What is one key distinction between bonds and stocks regarding taxation?
 - a) Bond interest is taxed at a higher rate than stock dividends.
 - b) Stock dividends are deducted from profits before taxation, while bond interest is not.
 - c) Bond interest is tax-deductible for companies, unlike stock dividends.
 - d) Stock dividends are not subject to any taxation.
8. What is a feature of the secondary market for bonds?
 - a) It allows bond issuers to change the interest rates on existing bonds.
 - b) Bondholders can sell their bonds at a price influenced by current market rates.
 - c) It eliminates the need for credit ratings on bonds.
 - d) Bonds traded here are always sold at their original face value.