Chapter 3: what do interest rates mean and what is their role in valuation

Cash flow - net cash and cash equivalents transferred in/out of a company.

present value (present discounted value) - the dollar of cash flow paid to you one year from now is less valuable to you than a dollar paid to you today.

Simple loan - the lender provides the borrower with an amount of funds that must be repaid to the lender at maturity date, along with interest.

Fixed-payment loan - lender provides borrower an amount of funds that must be repaid by making same payments every period that consists of principal and interest for set number of years.

Coupon bond - pays owner of the bond a fixed interest payment every year until the maturity date. When a specified final amount is repaid.

Coupon rate - the dollar amount of the yearly coupon payment expressed as a percentage of the face value of the bond.

Discount bond - is brought at a price below its face value, and the face value is repaid at the maturity date.

Yield to Maturity - the interest rate that equates the present value of cash flows received from a debt instrument with its value today.

For simple loans, the simple interest rate equals the yield to maturity.

perpetuity or Consol - a perpetual bond with no maturity date and no repayment of principal that makes fixed coupon payments of $C forever.

current yield - yearly coupon payment / price of the security

-current bond prices and interest rates are negatively related: when the interest rate rises, the price of the bond falls, vice versa.

nominal interest rate - interest rate that doesn't acount for inflation.

real interest rate - interest rates that is adjusted by subtracting expected changes in the price level (inflation)

rate of return - the net gain or loss holding a bond over a time period

Indexed bonds - bonds whose interest and principal payments are adjusted for changes in price level.

rate of capital gain - change in the bond's price relative to the initial purchase price.

Interest rate risk - riskiness of an assets return from interest rate changes.

reinvestment risk - ~~if an investor's holding period is longer then the term to maturity of the bond~~
proceeds from short-term bond need to be reinvested at a future interest rate that is uncertain