

BUSINESS

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Q&A Wall Street Beat

by scott johnson

certified financial planner

Dear Scott:

What is a Zero-Coupon Bond and why should an investor consider this type of bond?

Karen Ferguson
Education major

Dear Karen:

A Zero-Coupon Bond is a debt instrument where the principal of the bond is separated (stripped) from the stream of interest payments. Sometimes they are called Deferred Interest Bonds, Compound Interest Bonds or Capital Accumulator Bonds. Since these bonds pay no interest to

the bondholder, they are bought at a discount from face value (usually \$1,000). The longer the time to maturity, the deeper the discount will be.

The bonds can be issued by the U.S. Government, corporations or municipalities.

Zero-Coupon Bonds do not generate current income and are more volatile in their price fluctuations. Although they pay no current income they still earn a stated rate of interest and will trade at a premium or discount from par-value in the marketplace.

With the exception of tax-free Zero's, the interest earned is still currently taxable to the bondholder and the tax on the interest earned but not received must be paid in

the year it is earned.

There are advantages of Zero-Coupon Bonds. You can lock in a rate of interest, eliminating the reinvestment risk because your interest is automatically reinvested at the original yield. Coupons do not have to be handled and there are no delays with getting the interest payment invested.

Zero-Coupon Bonds can also be bought with relatively less money because of their deep discount from face value.

This is a word of caution for you. Since no interest is paid to you, you actually receive nothing until the bond matures. Be careful with your choice of bonds and purchase only high quality bonds with your low risk money. If a bond defaults, your loss could be greater because you

have received no interest payments to cushion the loss.

Investors will buy taxable Zero-Coupon Bonds for retirement accounts like IRA's. Also they will purchase those bonds for their children's college fund. Incidentally, any interest received by a child under the age of fourteen is taxable to the parent to the extent the interest exceeds \$1,000.

Generally, a Zero-Coupon Bond is a higher risk than a Coupon Bond and should occupy a slightly higher risk/return level in your portfolio.

Dear Scott:

How much money do I need to open a brokerage account?

Bobbie Hawkins,
undeclared major

Dear Bobbie:

A regular account can be opened for almost any amount. Many young investors start their capital accumulation programs by making regular purchases of mutual funds--perhaps \$500 to start and then \$100 per month.

Other investors may want to buy shares of stocks--perhaps 100 shares of an \$8 stock or 50 shares of a \$16 stock. There is no minimum number of shares you

must purchase. No minimum dollar amount you must pay.

In fact, if you want to open an IRA account, you can do so for as little as \$250.

NOTE: Scott Johnson is a graduate of finance at UNLV and is a certified financial planner with Shearson Lehman Brothers Inc. If you have any investment questions please drop them off at the Yellin' Rebel, third floor number of shares you MSU.

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