Dear Stock Market Game Teachers and Participants:

While it has probably been an interesting week in the classroom trying to contain your students’ excitement for the upcoming trick-or-treating festivities, Wall Street has also had a bit of its own sugar rush on recent news from Japan. The Bank of Japan has boosted its aggressive stimulus program in an effort to keep the country’s economic revival on track. The Nikkei index hit a seven-year high and markets around the world are following suit. This news comes on the heels of the Federal Reserve’s announcement on Wednesday that it will wind down its own economic incentives commonly referred to as “quantitative easing” which began in the Fall of 2008 during the financial crisis. During the past six years the Fed printed more than $4 trillion in extra money and used it purchase Treasury bonds and mortgage-backed securities. The result has been low interest rates nearing 0%.

In light of these recent global events and their impact on the markets, it may be a good time to review the subject of bonds with your students. Generally, when the stock market is on a roller-coaster ride, bonds can help steady a portfolio because they tend to be a safe investment tool to help balance the overall risk in a portfolio. In essence, bonds are loans investors make to the issuers in return for the promise of being paid interest, usually but not always at a fixed rate, over the loan term. The issuer also promises to repay the loan principal at maturity, on time and in full.

While all bonds share basic characteristics such as terms, rates, and par values (the face value, or named value of the bond – usually $1,000), they are not all alike. One of the major differences is that they’re issued or sold by four distinct entities in the U.S. Corporations issue bonds to raise money for expansion, research and development, and other expenses of doing business. While corporations can also raise money by selling new stocks, they may prefer bonds because the existing stocks lose value when new stocks are issued. Municipal governments, such as states and cities, sell bonds called “munis” to fund projects for the public good like building bridges, sewers, roads, and schools. The U.S. Treasury also issues bonds to meet its regular and unusual obligations. And finally, government agencies issue bonds to raise money to do their work, such as provide mortgages and student loans.

In terms of yield, it is the return the investor earns. The simplest version of yield is calculated by using the following formula: yield = annual interest (or coupon amount)/price. When an investor buys a bond at par value, yield is equal to the interest rate. When the price changes, so does the yield. The relationship of yield to price can be summarized as follows: when price goes up, yield goes down and vice versa. Technically, you’d say the bond’s price and its yield are inversely related.

For additional information about bonds and quantitative easing, be sure to check out the “Taper Time” edition of In the News located in the Teacher Support Center. This issue describes quantitative easing and the Fed’s taper and explains its impact on the stock and bond markets.

Also, be sure to take a look at www.investinginbonds.com. While the information provided may be a bit advanced for some students, the information listed under the Learn More section (on the right side of the page) is particularly helpful. It reviews bond basics, the different types available, as well as recommendations for every stage of an investor’s life.