CONCEPT: CALCULATING BOND AND STOCK PRICES

- The value of an investment can be thought as the _____ value of _____ cash flows
  - □ A bond will pay Interest Payments over the life of the bond, and a final Principal Payment

Timeline:

$$Bond\ Price = \frac{Coupon}{(1+i)} + \frac{Coupon}{(1+i)^2} + \cdots + \frac{Coupon}{(1+i)^n} + \frac{Principal}{(1+i)^n}$$

  - □ A stock pays dividends, but there is no principal repayment. However, it can be assumed the dividends will grow

Timeline:

$$Stock\ Price = \frac{Dividend}{(i-g)}$$

Where *i* = discount rate and *g* = dividend growth rate

PRACTICE: A stock currently pays a dividend of $1 per share. Dividends are expected to increase at a rate of 5% per year, while the discount rate is 8%. What is the current price of the stock?

a) $12.50
b) $20.00
c) $33.33
d) Cannot be determined