

### Chapter 6 – Example 3

Assume a corporate bond with a \$1000 face value matures 5 years and 7 months from today and has an annual coupon rate of 8% paid semiannually. There is a 10% chance that the issuer will default at maturity. If the firm defaults, it will pay 80% of what is promised (final coupon + face value) at maturity. Treasuries with the same maturity earn a yield to maturity of 2% and investors in these corporate bonds demand a 3% risk premium over the current rate on Treasuries (thus requiring an expected return of 5%) to compensate for the risk they face (All rates are APRs with semiannual compounding).

Calculate the clean price of the bond.