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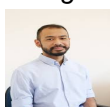
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## Chapter 3 What Do Interest Rates Mean and What Is Their Role in Valuation?

### Measuring Interest Rates

Present Value  
Four Types of Credit Market Instruments  
Yield to Maturity

### The Distinction Between Real and Nominal Interest Rates

Global Real, Negative Y-Rate Rates? A Case History

### The Distinction Between Interest Rates and Returns

Mini-Case Box: With TIPS, Real Interest Rates Have Become Observable in the United States

Maturity and the Volatility of Bond Returns: Interest-Rate Risk

### Reinvestment Risk

Summary

Mini-Case Box: Helping Investors to Select Desired Interest-Rate Risk  
The Practicing Manager: Calculating Duration to Measure Interest-Rate Risk  
Calculating Duration  
Duration and Interest-Rate Risk

### ■ Overview and Teaching Tips

In my years of teaching financial markets and institutions, I have found that students have trouble with what I consider to be very material because they do not understand what an interest rate is—that is, negatively associated with the price of a bond, that it differs from the return on a bond, and that there is an important distinction between real and nominal interest rates.

This chapter spends more time on these issues than does any other competing textbook. My experience has been that giving this material so much attention is well rewarded. After putting more emphasis on this material in my financial markets and institutions course, I witnessed a dramatic improvement in students' understanding of portfolio choice and asset and liability management in financial institutions.

An innovative feature of the textbook is the set of over twenty special applications called, "The Practicing Manager." These applications introduce students to real-world problems that managers of financial institutions have to solve and make the course both more relevant and exciting to students. They are not meant to fully prepare students for jobs in financial institutions—it is up to more specialized courses such as bank or financial institutions management to do this—but these applications teach them some of the special and/or hard tasks that they will need when they enter the business world.

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