What Is a Zero-Coupon Bond?

Learn more about what zero-coupon bonds are, how they make money, and how they might fit into your portfolio.

Most bonds in the investment universe work by providing a stream of regular interest payments to the investor over the life of the bond. When a typical bond comes due — or when the bond reaches its maturity — the investor receives the face value of the bond, and the transaction formally ends.

Zero-coupon bonds are debt securities that are sold at deep discounts to face value. As their name indicates, they don’t pay periodic interest payments, but they do reach full maturity at a certain point, and the bondholder then receives the face value of the bond, plus any accrued interest.

Understanding zero-coupon bonds

Zero-coupon bonds make money by being sold to investors at substantial discounts to face value. Zero-coupon bonds compensate for not paying any interest over the life of the bond by being available for far less than face value. Put another way, without a deep discount, zero-coupon bonds wouldn’t be especially competitive.

Continue reading.

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