Bonds

Bonds have long been considered a place of safety for investors to park their money and earn return on their capital. This year long-term bonds have fallen more than the equity market due to interest rate fluctuations that are potentially not understood by new investors.

Bonds are issued by corporations, municipalities, and governments as an agreement to repay the debt that is taken on by the entity for projects. Lenders to bonds will typically receive payments semi-annually (twice per year) from the borrowers at an agreed coupon rate which is used to calculate the annual payment to the lender. Bonds typically have a principal of $1000 that will be repaid to the lender when the bond matures along with the final coupon payment. For example, if a company issues a $1000 bond with a coupon of 6%, lenders will receive $60 in payments for the year (1000*6%).

Since bonds are tied to interest rates (due to their coupons), they must re-rate themselves to the interest rate movements in the market. As interest rates go down, the bond price (principal) will increase to reduce the yield that the lender will receive in the year. The opposite is true for when interest rates increase, bond prices will move lower to reflect the higher interest rates that investors can receive in the bond markets.

This year, interest rates have increased at a faster pace than at any point in history. Because of this, bond prices have fallen dramatically across the board for all issues.