THE BOND SEE-SAW

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One of the most important but perplexing relationships in finance is that interest rates and bond prices move in opposite directions.

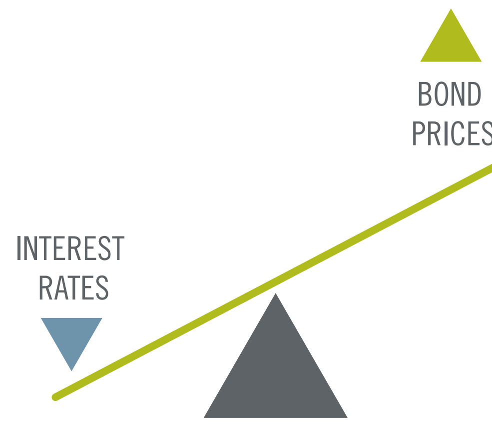
Why do bonds work this way?

A bond is a loan to another party (usually a corporation or government) who, if all goes well, will pay you back when the bond matures. Along the way, that party will pay you interest. But every day, interest rates change, which means that newer bonds may be issued at different yields.

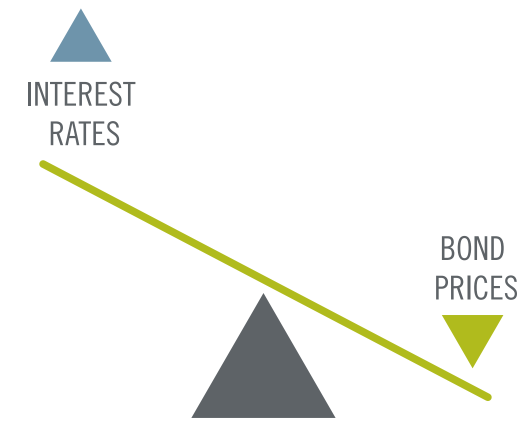
If interest rates rise, bonds which were issued with a lower yield become less desirable to investors, and their prices fall. Conversely, if rates fall, investors will seek out higher yielding bonds, pushing their prices higher.

Understanding the price/interest rate "see-saw" is foundational to smart investing.

When rates go down,
prices rise.



When rates go up,
prices fall.



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