Unbiased Financial Information Provided by Financial Wisdom.

Bond Values and Interest Rates Changes

Bond values are determined in the marketplace and those values change in the opposite direction of changes in interest rate changes. When interest rates rise, bond values fall. When interest rates fall, bond values rise. The magnitude of the change in values is greatly influenced by the length of time until the bond's maturity. The longer time until maturity, the greater the change.

Most people invest in bonds to receive the periodic interest payments and often intend to hold them until they mature. In that situation, changes in interest rate conditions (and resulting changes in bond values) probably have very little, if any, impact on the bond owner. They will still get their interest payments, and on maturity of the bond they will get their principal returned.

However, some investors may need to sell their bonds before maturity and are subject to this type of risk. This risk is often called "interest rate" risk.

Is this important to you?
Probably not, if you own bonds and intend to keep them until maturity. If however, there is a chance you may need to sell a bond investment before maturity, you may want to consider owning bonds with shorter maturities. That way, the impact of an unexpected rise in rates will not be as great. You may end up accepting a somewhat lower interest rate, but you will reduce your interest rate risk.

You should also consider interest rate risk when choosing a bond mutual fund. There are many funds available with different maturity objectives. Choosing a fund with shorter or intermediate maturities can reduce the risk that the fund's value will drop if interest rates rise.

What should you do?
First, remember that interest rate risk exists for all types of bonds when choosing your bond investments. Second, consult with your investment advisor to help choose the bonds that best suite your needs. Finally, if you are buying a bond mutual fund, be sure to read the prospectus and other materials describing the fund.