Bond Pricing

Accounting & Finance

Why bond prices move opposite to interest rates.

A bond's price is the present value of its coupons and principal at the market yield.

$$\text{Price} = \Sigma\, C/(1+y)^t + F/(1+y)^n$$

Yield rises Always.	**Price falls**
Yield equals coupon	**Price equals par**
Longer maturity Higher duration.	**More price sensitivity**

THE COMMON MISTAKE

× **Assuming bonds are safe from loss**

✓ **Rate rises cause real capital losses**

A long-dated bond can fall 20% or more when yields rise, even with no default risk whatsoever.

> **Duration measures that sensitivity: roughly, price falls by the duration times the change in yield.**