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Factors that Affect Bond Prices by Chris Adam

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Investors treasure bonds, as they are relatively less volatile than stocks. However, there are a lot of factors that influence bond prices. These factors make bonds extremely vulnerable to economic changes subsequently depreciating their prices. The movement of bond pricesbond pricing is inversely proportional to interest rates, which means higher the interest rates, lower the bond prices and vice versa.

For instance, if a bond was issued for $10,000 for five years with an interest rate of 6% paid to investors every six months and you wished to sell it at a time when the interest rate went up, you would have no other choice but to discount the face value. of the bond so that the buyer could get a market rate for the bond. On the other hand, if the interest rate had gone down, you would get a chance to sell it at a premium over face value.

Understanding the way bond pricingbond pricing moves, is a little tricky and requires a lot of experience in bond trading. This does not mean investment in bonds is not profitable. But if you are not ready to risk big money, then you must choose shorter term bonds than those with longer terms. A broker would give you an idea as to how bond prices change and the risks associated with holding long-term bonds.

It is safe to conclude that inflation is your worst enemy when it comes to prices of bonds. It is very logical; there is rise in inflation expectations, interest rates, and bond yields leading to a sharp fall in bond prices. You need to study the economic activity or consult an expert who can predict future economic activity while trading in bondsthem. Financial experts usually analyze the yield curve to understand the movement of economy to help you make sound financial decisions that can reap long-term benefits.

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