STANDER FINANCIAL



WHEN INTEREST RATES RISE, WHAT HAPPENS TO YOUR BONDS?

How oil prices, inflation and interest rates can affect the "conservative" side of your investments.

NEWS HEADLINES: OIL PRICES ARE UP!

If you've looked at the news lately, you've probably seen stories about oil prices, inflation, interest rates and the Federal Reserve.

These issues can seem unrelated, but they can all connect back to something you probably care a lot more about:

Your retirement portfolio.

Changes in energy prices can contribute to inflationary pressure, and inflation can influence expectations around interest rates.

And when interest rates change, the value of your bond investments can change too.

So here's an important question: **Why can a bond lose value when interest rates rise?**

Let's take a look at how that works, and why it matters when you're planning for retirement.

SO, WHAT EXACTLY IS A BOND?

A bond is simply a loan.

When you buy a bond, you're lending money to a government, a corporation, or another organization.

In exchange, they agree to pay you interest. When the bond reaches its maturity date, they generally repay the original amount you invested.

Think of it this way: You're the lender, and the bond issuer is the borrower.

But not all bonds are the same. Some are issued by the U.S. government, while others are issued by companies. They can carry different levels of risk and pay different amounts of interest.

Not all bonds are the same.

Government Bonds	Corporate Bonds
Issued by the U.S. government	Issued by companies
Lower risk	Higher risk
Lower interest	Higher interest

And here's something important to understand: owning a bond doesn't mean its market value will always stay the same.

You can continue receiving the interest payments a bond promises while the price someone is willing to pay for that bond changes.

That's where interest rates come into the picture.

A BOND IS MORE THAN ITS INTEREST PAYMENT

Income

The interest payments the bond is scheduled to make.



Market Value

What the bond could be worth if it were sold today.

When you own a bond, there's an important distinction to understand: **the interest it pays and what it's worth in the market aren't the same thing.**

You can continue receiving the interest payments your bond promises while its market value moves up or down.

So why does that happen?

It often comes down to changes in interest rates.

HERE'S WHAT HAPPENS WHEN RATES CHANGE

Your Existing Bond

4% Interest

New Bond



6% Interest

Imagine you own a bond that pays **4% interest.**

Now imagine that newly issued bonds are paying **6%.**

Your bond didn't suddenly stop paying 4%.

The problem is that investors can now find similar investments offering a higher rate.

So if you wanted to sell your 4% bond, a potential buyer would have less reason to pay full price when comparable bonds are offering 6%.

Because of that, the market value of your existing bond may fall.

That's one reason interest rates and bond prices generally move in opposite directions.

THE INTEREST-RATE RELATIONSHIP

When Interest Rates Rise	When Interest Rates Fall
New bonds may offer higher yields.	New bonds may offer lower yields.
Existing bonds with lower rates become less attractive.	Existing bonds with higher rates can become more attractive.
Existing bond prices generally decline.	Existing bond prices generally increase.

Interest rates and existing bond prices generally move in opposite directions.

This can seem backwards at first.

But once you separate a bond's **interest payment** from its **market value,** it starts to make more sense.

WHY DOESN'T EVERY BOND MOVE THE SAME AMOUNT?

- Shorter Duration
- Intermediate Duration
- Longer Duration
- Less Rate Sensitivity
- More Rate Sensitivity

This is where another concept comes into play:

Duration.

Duration helps investors understand how sensitive a bond or bond portfolio may be to changes in interest rates.



What Duration Tells You
Duration measures how sensitive a bond's price is to changes in the market yields. Although it's expressed in years, it is not the same as the number of years until the bon matures.

Here's a simple rule of thumb



For every 1% increase in interest rates, a bond's price may fall by approximately 1% for every year of duration. The reverse generally applies when rates fall.

For example, if you own a bond with a duration of 7 years, a 1 percentage-point increase in its yield could mean an approximate 7% decline in its market value.

On a $10,000 investment, that's about $700.

And if rates fall by 1 percentage point, the same bond could see an approximate 7% increase in market value.

What Does This Look Like In Real Life?

Different bonds can have very different durations.

01

Short-Term Treasury Bonds

A short-term Treasury investment might have a duration of around 2 years. That means a 1 percentage-point rise in its yield could translate to an approximate 2% price decline.

02

Intermediate-Term Treasury Bonds

An intermediate-term Treasury investment might have a duration around 5 years. The same yield increase could mean an approximate 5% price decline.

03

Long-Term Treasury Bonds

A long-term Treasury investment might have a duration around 15 years. A 1 percentage-point rise in its yield could mean an approximate 15% price decline.

What About High-Yield or Emerging-Market Bonds?

This is where it gets interesting.

High-yield corporate bonds and emerging-market bonds can carry more credit risk than U.S. Treasury bonds. That means there's a greater risk that the issuer could run into financial trouble or fail to make its payments.

But more credit risk doesn't automatically mean longer duration.

A high-yield bond could have a shorter duration than a long-term Treasury, yet still carry greater overall risk.

That's why it's important to understand both how sensitive a bond is to interest-rate changes and how much risk the issuer carries.



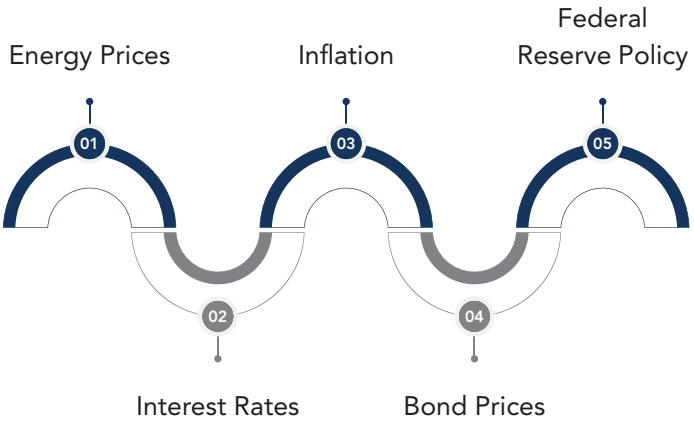
Two investments can both be part of the bond portion of your portfolio and behave very differently when market conditions change.

Duration ≠ Maturity

Maturity tells you when a bond's principal is due to be repaid. Duration helps you understand how much its price may change when market yields move.

For example, a bond that matures in 10 years might have a duration of around 8 years.

SO WHERE DOES OIL COME INTO THE PICTURE?



Oil prices are only one factor among many that can affect this chain.

Oil prices don't directly determine the value of your bonds.

But energy prices can affect the broader economy.

When energy costs rise significantly, they can put upward pressure on transportation, production and other goods and services.

That can contribute to inflationary pressure.

Inflation is one of the factors the Federal Reserve considers when making decisions about monetary policy.

And monetary policy can influence interest rates, which can affect the market value of existing bonds.

The relationship isn't automatic, and oil prices are only one factor among many.

The important thing is to understand the connection.

A headline about oil prices can eventually have implications for the bond market.

"I THOUGHT BONDS WERE THE SAFE PART OF MY PORTFOLIO?"

Conservative ≠ No Volatility

A conservative investment can still decline in value.

This is an understandable question.

Bonds are generally less volatile than stocks, **but less volatile does not mean they cannot lose value.**

So why do people still value bonds?

Because bonds can play an important role in a retirement portfolio. They can provide **regular income**, help **diversify a portfolio**, and provide a **level of stability** compared with more aggressive investments.

And there's an important distinction here:

A bond can decline in market value while still continuing to make its scheduled interest payments.

That income can be especially useful in retirement, when you may be relying on your investments to help support your cash flow.

At the same time, the value of a bond investment can change based on several factors, including:

Interest-rate changes	Credit risk	Inflation
Maturity	Duration	Overall market conditions

So when someone describes part of a portfolio as **"conservative,"** that doesn't mean the account value will never decline.

It means the investment has a different risk and return profile than something like a stock portfolio.

Understanding that difference is important. A bond investment can have a temporary decline in market value while still serving the purpose it was intended to serve.

And to understand why that happens, it helps to look at some of the factors that can cause bond prices to move in the first place.

DON'T JUST ASK WHY IT'S DOWN



Don't Just Ask:
"Why is this investment down?"

Also Ask:
"What is this investment supposed to do for me?"

When you see a bond investment decline, it's natural to focus on the number.

But there's another question worth asking:

"What is this investment supposed to do for me?"

For one investor, bonds may primarily provide income.

For another, they may provide diversification or stability.

The point is, **the role of the investment matters.**

A temporary decline in market value doesn't automatically mean the strategy has failed.

Understanding what you own and why you own it can make market movements a lot easier to put into perspective.

THE BOTTOM LINE

A bond's income and its market value are two different things.

That's an important distinction to understand, especially when interest rates are changing.

So the next time you see a headline about oil prices, inflation or the Federal Reserve, think beyond the headline:

What could this mean for interest rates?

And then:

What could that mean for the investments I own?

That's the bigger picture.

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