

Capstone Comments

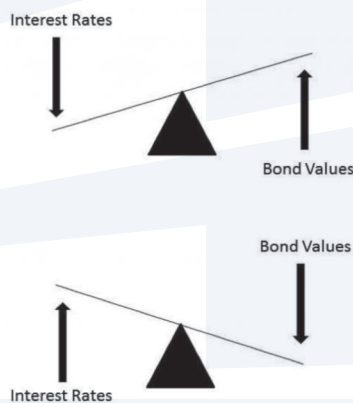
A forum for communicating information about the management of assets

Q:
A:

How do bonds and bond funds react to changes in interest rates?

Most investors purchase bonds or bond funds in order to provide an income stream and portfolio diversification. The fact that most bonds provide a steady income stream may lull investors into thinking that there is little risk to these investments. This is in fact not true. Bonds are often used to help offset volatility, since stocks and bonds generally move in opposite directions and bonds may be considered less volatile than stocks. Bond markets actually react to many factors, such as interest rates, Federal Reserve policy, economic conditions, inflation and the financial health or credit rating of the bond's issuer. In this newsletter we want to focus on the affect changes in interest rates have on bond values.

Bond values have an inverse relationship with interest rates. Very simply put, when interest rates rise, bond values fall and when interest rates fall, bond values rise. The teeter-totter image below gives you a visual example of how this works.



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If you have questions that you think would be interesting for our readers, please call Kerrie at 406-325-1500 or email your questions to kkern@capstoneretire.com.

It is important to also understand how the fluctuation of bond values due to interest rate movements are directly related to the maturity length of a bond. Maturity is the date at which a bond is due and payable, meaning the date when the bondholder receives their principal and final interest payment. Generally, the longer the bond's maturity, for example a bond maturing in ten years versus another that matures in two years, the more it's affected by changing interest rates. A ten year bond will usually lose more of its value if rates go up than a two year note.

If you have any questions regarding the bond or fixed income portion of your portfolio, please feel free to contact us or discuss it at your next review meeting.