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Bonds
explained

U.S. Bonds Sell-Off: What Falling Bond Prices Tell Investors



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A U.S. bond sell-off occurs when selling pressure pushes bond prices lower and yields higher. These moves can reflect changing expectations for interest rates, inflation, and economic growth. They can also affect borrowing costs, existing bond holdings, and potential opportunities for investors purchasing newly issued bonds.

Why U.S. Bond Prices Fall During a Sell-Off

Bond prices and yields generally move in opposite directions. A Treasury security's coupon payment is fixed when it is issued. If market rates rise, newly issued bonds may offer higher yields, making an older bond with a lower coupon less attractive. Its price generally has to fall so that a buyer can earn a yield closer to the prevailing rate. When rates fall, the opposite can occur. Older bonds with higher coupons may become more valuable. The SEC describes this exposure as interest-rate risk. - N/A

A U.S. bond sell-off can have several possible causes. Investors may expect the Federal Reserve to keep short-term rates higher, worry that inflation will reduce the purchasing power of fixed payments, or anticipate stronger growth that delays future rate cuts. Concerns about heavier government borrowing can also affect yields because investors may require more compensation to absorb additional Treasury supply. No single market move proves which factor is responsible.

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Longer-term bonds generally experience larger price changes when yields move because more of their value comes from payments that will not arrive for years. Duration measures this interest-rate sensitivity. Although duration and maturity are related, they are not identical; coupon size and other bond features can also affect duration.

How Rising Yields Can Reduce a Bond's Value

To show how rising yields could affect a bond's value, let's break down the example of a \$10,000, 10-year Treasury note with a 3% coupon. It pays \$300 in annual interest in this simplified example regardless of what happens to prevailing market yields.

These figures are mathematical illustrations rather than observed market prices. Each estimated price is calculated by discounting the bond's 10 remaining \$300 annual interest payments, along with its \$10,000 principal payment at maturity, using the stated market yield as the discount rate. As the required market yield rises, the present value of those fixed payments falls.

The estimates also assume annual payments, no accrued interest and no transaction costs.

Actual Treasury notes pay interest semiannually, so their market prices would differ modestly from this simplified example.

When the market yield is 3%, the bond is worth approximately its \$10,000 face value. At a 4% yield, a new \$10,000 bond priced at face value would provide roughly \$400 annually in this simplified example. The existing bond's fixed \$300 payment is less competitive, so its price falls to about \$9,189. At a 5% yield, its estimated value drops further to approximately \$8,456.

What Higher Treasury Yields Can Tell Investors

Rising Treasury yields can reflect expectations that short-term rates will remain elevated, inflation concerns, stronger growth or a higher premium for holding long-term debt. Longer-

term Treasury yields can be viewed as reflecting expected future short-term rates plus a term premium, which helps explain why a yield increase does not have one definitive meaning.

Treasury yields also serve as reference rates across financial markets. Mortgage rates typically move with longer-term Treasury yields, though not one-for-one. [Corporate bond](#) yields are often evaluated as a comparable Treasury yield plus a credit spread. Therefore, a sustained rise in Treasury yields can contribute to higher borrowing costs for households and businesses.

Changes at different maturities also reshape the yield curve. A steepening curve means the gap between long- and short-term yields is widening, while a flattening curve means it is narrowing. These shifts can provide information about policy, inflation and growth expectations, but their meaning depends on which yields are moving and why.

How a Bond Sell-Off Affects Bond Funds and New Investors

A bond fund's share price can fall when the value of its holdings declines. Funds with longer duration generally have greater sensitivity to rising yields, so a long-term fund may experience a larger decline than a short-term fund after the same rate increase. [Bond funds](#) can lose money even when they hold government securities.

Falling prices create a near-term loss in market value for existing shareholders, but higher yields may improve future income. As bonds mature or holdings change, a fund can replace lower-yielding securities with newer bonds paying more. This may help offset part of the decline over time, but the result depends on duration, credit quality, expenses and future rate changes.

New investors may also obtain more income for each dollar invested when yields are higher. But buying after a [sell-off](#) does not eliminate risk. Yields could rise further, and non-Treasury bonds carry credit risk in addition to interest-rate risk.

What to Consider When Bond Prices Are Falling

Selling a bond below its purchase price can turn an unrealized loss into a realized one. An individual bond held to maturity has a stated repayment date and amount, subject to the issuer's ability to pay. However, receiving the bond's face value at maturity does not necessarily prevent a loss if the investor originally purchased the bond above face value. A conventional bond fund continually changes its holdings and does not have one maturity date when shareholders automatically receive principal back.

Before changing an allocation, investors can review duration, maturity dates, and credit quality. They may also consider when the money will be needed, whether the bonds are intended to generate income or reduce investment portfolio volatility and whether higher current yields support their plan. Shorter maturities may limit rate sensitivity, while longer maturities involve different income and reinvestment trade-offs.

A **financial advisor** can help you evaluate how a bond sell-off affects your portfolio, income needs and broader asset allocation. Your response may depend less on a market headline than on whether your existing strategy still aligns with your time horizon, liquidity needs and tolerance for price fluctuations.

Bottom Line

A U.S. bond sell-off pushes prices down and yields up. That can reduce the current value of existing bonds and bond funds while increasing the income available on newly purchased securities. Investors may want to distinguish between interim price changes and holding an individual bond to maturity before deciding whether to buy, sell, or maintain an allocation.

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bond
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A Stanford economist explains the bond market

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Finance Professor Hanno Lustig lays out how the bond market works and what you need to know to make sense of the headlines.

The U.S. bond market has been making headlines in recent weeks as bond yields reach rates not seen since 2007. But what exactly are bond yields, and what causes them to rise? Here, Stanford finance Professor **Hanno Lustig**, an expert on **U.S. public debt**, explains why rates are rising right now and what that means for the broader market.

Can you start with a brief overview of the U.S. bond market and how it works?

Quite often, the government runs deficits, meaning it spends more than it takes in from tax revenue. To finance the deficit – the gap between what the federal government takes in and what it spends – the government has the U.S. Treasury auction off debt in the form of bills, notes, and bonds. These are different instruments with different maturities, but each is essentially a promise by the Treasury to repay a fixed amount of principal – say \$1 – on a set future date: one year out for a bill, and five, 10, 20, or 30 years out for notes and bonds. Until that security matures, the Treasury also makes regular interest payments, called coupons, usually every six months. So the holder collects coupons twice a year and gets the principal back at maturity.

Basically, it's how the federal government has been keeping the lights on.

Historically, the U.S. has been in a privileged position because of a strong demand for U.S. Treasury bonds, including from foreign investors. It used to be the case that when bad things happened in the world – like the Great Financial Crisis of 2008 – foreigners rushed to buy U.S. Treasuries, a phenomenon called "flight to safety." There was something about having the U.S. Treasury stamp on a bond, compared with other issuers like corporations, that made people feel safe about their investment – so much so that they were willing to pay a little bit extra for that security.

As a result, the federal government has been able to sell bonds at a premium relative to their value, that is, what they're really worth. That's been great for U.S. taxpayers because it reduces the U.S. government's borrowing costs. In other words, the U.S. government has effectively been borrowing at a lower yield or interest rate.

What is a bond yield?

The bond yield is the annual return an investor earns from holding the bond until maturity, expressed as a percentage of its price. When bond prices fall, yields rise, and vice versa.

Why are bond yields rising right now?

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Bond yields rise for a number of reasons.

One is that investors expect interest rates to rise in the future. But it's also because investors perceive 10-year bonds as riskier. If something bad happens – say inflation suddenly goes up, which erodes the value of these promises to bondholders – they are going to take a bigger loss on their 10-year bond than they would with a one-year bond. As a result, a buyer wants to be compensated for taking on that risk, which is a concept known as the "term premium." They will receive an additional return by buying a 10-year bond instead of a one-year bond and rolling it over.

Another reason bond yields have risen now is that the safety premium is disappearing. People don't have as much faith in the fundamental safety of Treasuries as they used to, and many investors are increasingly concerned about the U.S. fiscal situation.

Why are investors nervous?

The federal government has been running deficits for the past 25 years. The Congressional Budget Office (CBO) projects that the federal government will continue to run large deficits for the next 30 years. A major reason is promises to older Americans through Medicare, Medicaid, and Social Security. Keeping those promises means the federal government will run deficits.

But the government has also made promises to bondholders. At some point, the government will have to figure out which promises to keep and which to renege on. That's a politically difficult call to make.

The federal government is spending an increasing share of its tax revenue on interest expenditures, which go to bondholders – the investors who own Treasury securities. That includes domestic holders (individuals, pension funds, mutual funds, banks, and the Federal Reserve) and foreign holders (foreign central banks, governments, and private investors).

Right now, the U.S. spends between 3-4% of its GDP on interest, which, to give you an idea, is the equivalent of the defense budget. If you look at the CBO projections, to reduce the deficit, policymakers have to accept continued interest costs of 3-4% of GDP, cut spending, or raise taxes – and none of those is easy.

This is not unique to the U.S. If you look at most Eurozone countries, they face similar fiscal predicaments. The key difference is that the U.S. economy is still growing, and, hopefully, with AI, it will deliver additional growth. Economic growth solves a lot of these problems.

How does the bond market impact mortgages, car loans, and other kinds of consumer borrowing?

The key point is that yields on U.S. Treasuries serve as the benchmark for essentially all other fixed-income borrowing. Rates on fixed-rate mortgages and car loans are tied directly to those Treasury yields. Lenders start from the relevant Treasury yield and then add a spread on top to compensate for risk, such as the chance that a household defaults on its mortgage or car loan. So when Treasury yields rise, the rates households pay on mortgages, auto loans, and other forms of consumer

borrowing tend to rise right along with them, and when yields fall, that borrowing gets cheaper. That is the channel through which the bond market reaches ordinary people's monthly payments.

