SIGNIFICANCE OF YIELD IN BOND MARKET

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When equity markets are bullish we say " the Sensex has "gone up" or "Equity prices have "gone up"

BUT

When bond markets are bullish we say "yields" have "gone down"

Why??

SIGNIFICANCE OF YIELD IN BOND MARKET

When bond markets move up, we say that "yields" have gone down whereas when bond markets fall we say the "yields" have gone up

Thus there seems to be an inverse relationship between the markets and the "yields"

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HOWEVER

It is quite the opposite with Equity Markets where the “SENSEX” is said to go up with rising markets and go down with falling markets

THUS

There seems to be a direct relationship between the equity markets and the SENSEX

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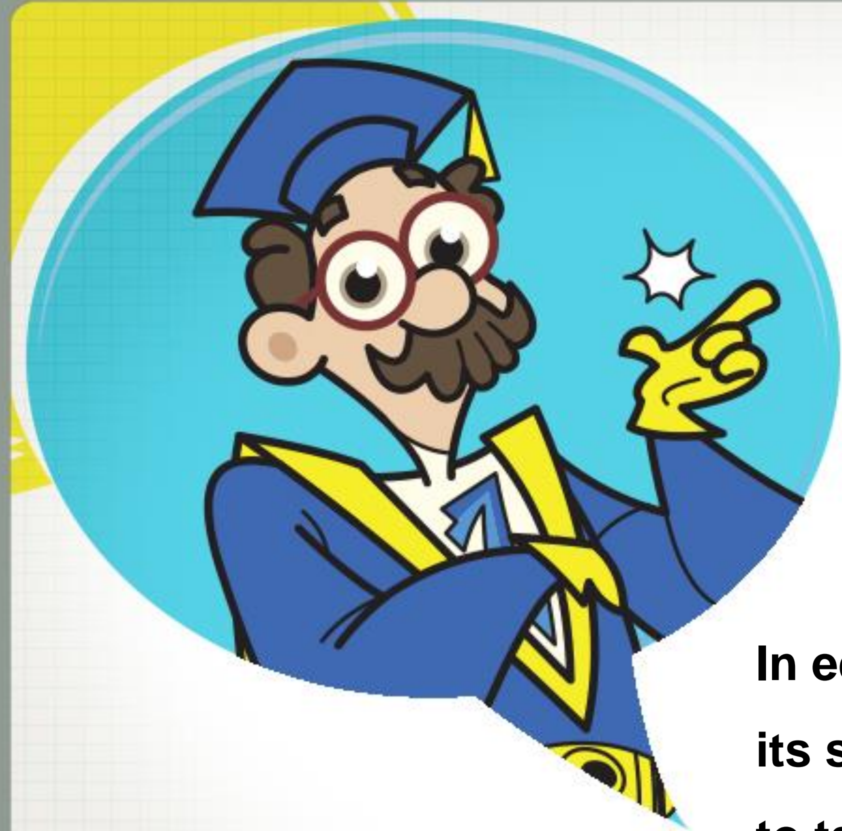

In equity markets a business offers its shares to investors who are willing to take a risk on the business succeeding and thereby making big gains.

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In a bond market the business raises debt capital where the investors invest money for a fixed period at a particular rate of interest.

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When the bond markets are bullish (positive) it means there are many investors who are willing to lend money.

In such a situation the business can expect to raise capital at a lower interest rate or “lower yield”

Hence we say that “when bond markets are bullish the yields fall”.

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Let me explain with an example. Let's say I issue a debt paper of Rs. 100 each at 10% interest p.a.

This means that an investor who lends me Rs 100 for one year will earn Rs 10 at the end of the year. Thus at the end of the year I will return
Rs. 110 (Rs 100 + Rs 10)

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In a bullish market there are several investors who want to invest and papers are in short supply.

In such a situation, perhaps I would find an investor who is willing to pay Rs105 for my debt instrument for which I had paid Rs 100 to the original issuer for earning a 10% interest.

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In this situation I become the issuer to the new investor who purchased the debt paper from me for Rs 105.

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The earning of the new investor works out to be

Rs 110 – Rs 105 = Rs 5

And the amount of interest he earns works out to

(Profit/Invested amount) x 100 = {5 / 105}% = 4.7%

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Thus we see that when the market is bullish the yields come down and one is able to raise capital at lower interest rate.

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I hope this lesson has succeeded in clarifying this concept.

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I will be glad to receive your feedback on this lesson to understand if there any gaps.

Your feedback will help me improve my lessons going forward. Also if you wish to demystify any other concepts, please write to me about them.

Thinking of Investment

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