

What's a Bond Investor to Do in a Bearish 2017?

By Kathy A. Jones • Jan. 25, 2017 3:19 p.m. ET

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Unlike the stock market, where a 20% drop in prices is considered the marker of a bear market, there is no consensus about what constitutes a bear market in bonds. Perhaps that's because bond yields have been in a secular, or long-term, bull market since September 1981, when 10-year Treasury yields hit 15.8%. Within that 35-year downtrend, however, there have been at least nine periods when yields rose substantially—that is, by more than 100 basis points or at least 25% from starting levels.

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To distinguish between temporary spikes and actual bear markets, we think it's reasonable to define a bear market in bonds as a sustained decline in prices (or rise in yields, which move inversely to prices) during a period of tighter monetary policy from the Federal Reserve. By that definition, there have been four cyclical, or short-term, bond bear markets over the past 25 years, including the so-called "taper tantrum" in 2013-2014 when Treasury yields surged as the Federal Reserve suggested it would gradually cut back on its bond-buying program.

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First, reduce the duration in your portfolio. Bonds with shorter durations tend to be less volatile when interest rates move up (a Schwab bond specialist can help you determine the duration of your bonds or fixed income holdings). To estimate the impact of rising rates on a bond, look at the bond's duration. A bond with a duration of five years typically will move down in price by about 5% for every 100-basis-point increase in interest rates. A bond with a 2-year duration typically will move down by about 2%.