

Bonds and bond portfolios may appear to lose money immediately after purchase. There are two primary reasons for this:

## 1. Accrued Interest Paid Upfront

Unlike stock dividends, where you must own the shares on a certain day to receive the dividend, bond interest accrues daily. In other words, every day you own a bond, you are entitled to a day of interest. Therefore, when you purchase a bond, you must pay the seller their portion of the ‘accrued interest’ – their portion of the interest that has built-up since the last coupon payment. As you are the new bondholder, you will be the one who receives the full semi-annual interest payment on the next coupon date. You have effectively advanced the seller their portion of the six-month coupon and you will get that money back when the company pays you the coupon. This accrued interest is not included in the market value estimate that your custodian puts on the bond the next day, therefore, your value will appear to be lower than the amount you paid for the bond the day after you purchase it by at least this amount.

## 2. The Bid-Ask Quote on Bonds

Bond prices are quoted with a ‘bid-ask spread’. When you buy a bond, the price is based off the ‘ask’ quote or, in other words, what a seller is willing to sell a bond for. When you sell a bond, the price is based off the ‘bid’ quote or, in other words, what a buyer is willing to pay for a bond. In practice, an experienced bond manager will be able to buy somewhere in between the two. Additionally, there is a high probability that you will be holding that bond ‘to maturity’ – or the date the company pays your principal back. In such a case, the minute-to-minute price of the bond is largely irrelevant. To complicate matters, there is no central pricing and quote system for bonds like the stock market - every bank and brokerage chooses their own mechanism to assign a ‘current price’. Every firm that buys/sells bonds makes their own markets (meaning they setup their own pricing (ask/bid). Because of this, if you ask five firms at the exact same moment what a bond is trading at, you will likely get five different answers.

All of the above factors contribute to why a new bond portfolio appears to lose value immediately after construction. These factors ultimately have nothing to do with the returns of your bond portfolio.

To read more on these topics:

<https://www.aaii.com/journal/article/2-bond-basics-for-individuals-a-guide-to-buying-and-selling>