Yields and interest rates

We saw that the yield on a bond is defined as an internal rate of return — specifically, one that equates the discounted stream of future payments associated with the bond (where the discount rate *is* the yield) and the current market price.

Bonds typically have a complex structure. Fortunately, we can simplify. If we take the current yield on a bond, i_t, we can imagine an alternative investment (akin to a bank offering an interest rate equal to the same amount). Accordingly, if we invest \$1 for a year at the prevailing interest rate, we will end up with $(1 + i_t)$ at the end of the year.

As I mentioned, yields typically vary with the investment horizon. In the same way, banks will offer different interest rates depending on how long you are prepared to hand your money over for.