

Brian H. Card, MBA – Financial Advisor
142 E. Main Street, Princeville, IL 61559
4924 W. American Prairie Drive, Peoria, IL 61615
(309) 385-4375 bcard@p-s-b.com

Interest Rates: Be Ready for Anything

Most economists expect the Federal Reserve to keep interest rates fairly low in 2010 in order to encourage job growth.¹ Yet in reacting to the banking crisis in 2008, the Fed also created conditions that some say are ideal for reigniting inflation. If inflation were to become a serious threat to the economy and job creation, the Fed might have no other choice but to raise interest rates.

In other words, anything can happen. Current conditions make it difficult to anticipate where interest rates will be even a year from now. Where does this leave bond investors? Same place they have always been: unable to accurately foretell the future.

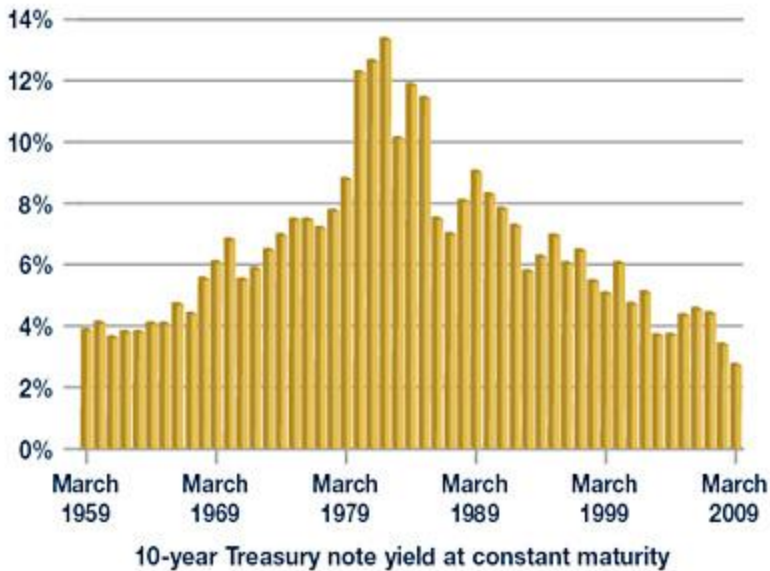
Fortunately, there is a strategy to help bondholders limit the risk of continued low rates *and* put them in a position to benefit if rates go higher.

Get Ready to Stagger

Individual bonds, when held to maturity, are generally not subject to interest-rate fluctuations. The terms are fixed when the bond is issued, allowing the bondholder to know exactly how much income the bond should generate and when the principal will be returned (assuming the borrower does not default).

ON THE MARCH

If you had bought 10-year Treasury notes that always matured in the month of March, the interest rate at which you would have been able to reinvest would have fluctuated widely over the past 50 years.



Source: Haver Analytics, 2009, for the period March 1959 to March 2009. U.S. Treasury securities are guaranteed by the federal government as to the timely payment of principal and interest. A Treasury security sold prior to maturity may be worth more or less than the original price paid.

However, once a bond matures, there is the risk that the investor will have to reinvest the principal at a lower interest rate. Likewise, there is also the risk that interest rates will rise after an investor has purchased a particular bond and subsequently doesn't have cash to reinvest at the higher rate.

One way to help manage rate volatility is by building a *bond ladder*. This strategy involves purchasing bonds with staggered maturity dates so that at least one bond matures every year or two. If rates have fallen, only a portion of the principal is reinvested. If rates are heading higher, the investor has an opportunity to reinvest at least some principal at the higher rate. Think of it as another form of diversification, one that spreads risk over time. Diversification does not guarantee against loss; it is a method used to help manage investment risk.

The principal value of bonds may fluctuate due to market conditions. Bonds redeemed prior to maturity may be worth more or less than their original cost. Investments seeking to achieve higher yields also involve a higher degree of risk.

A bond ladder has no effect on the risk of bonds themselves, but using a ladder strategy may put you in a better position to benefit from attractive rates as well as protect against falling rates. By purchasing bonds that mature at intervals, rather than all at once, you may be structuring your portfolio to help withstand the inevitability of interest-rate fluctuations.

1) The Wall Street Journal Economic Forecasting Survey, October 2009

The information in this article is not intended as tax or legal advice, and it may not be relied on for the purpose of avoiding any federal tax penalties. You are encouraged to seek tax or legal advice from an independent professional advisor. The content is derived from sources believed to be accurate. Neither the information presented nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. This material was written and prepared by Emerald. © 2010 Emerald.