

## **Retirement: Getting Ahead of Interest Rates**

Interest rates have to rise some time.

"Despite ongoing fears that high unemployment and Europe's debt woes could push the U.S. into a double-dip recession, the economy remains solidly in recovery territory, say some economists and analysts. Consumer confidence is on the rise, while economic activity among manufacturing and service firms continues to expand. Further, the amount of time it's taken the country's gross domestic product to reach earlier highs has been relatively short. Meanwhile, the jobs picture has been improving, adding about 200,000 jobs on average between January and May.

Although the Federal Reserve's official stance on interest rates remained at near-zero levels when policy makers met today, at least one Fed bank president, Thomas Hoenig of Kansas City, has called for tightening short-term rates this summer. Of course, the Fed is keeping a close watch on inflation, which has recently fallen below the U.S. central bank's informal target of 1.5% to 2%. If the inflation picture continues to erode, a rate hike may be a long way off.

Still, even buy-and-hold retirement investors can't ignore the changing times, says Dean Barber, a wealth manager. In particular, "people who are within five years of retirement or those already retired can't afford to make mistakes," he says. "That's the 'red zone' -- the time when many mistakes can be irreversible."

Here are four fixed-income tips for protecting your nest egg if, or better yet, when interest rates rise:

**Keep it short:** Depending on when rates go up, consider boosting your exposure to assets with shorter time horizons such as bonds that mature in one to two years or less, says Jim Scheinberg, a managing partner at an investment advisory firm. That way, if interest rates do rise, you won't be stuck with bonds that no one wants. In a sense, "you'll be locked in to low interest rates while everyone else is making a lot more," says Scheinberg. This strategy hinges, of course, on being able to get out in front of a rate hike, which no one really knows when will happen. Advisers often caution investors from attempting to time the market, as they're typically wrong, says Scheinberg.

**Keep it diversified:** Even with high volatility and dismal market returns, clinging to so-called safe investments like money-market funds, can be a losing battle, says Mickey Cargile, of WNB Private Client Services. Instead, he suggests creating a diversified bond portfolio comprised of investment-grade corporate bonds and international-bond funds. And although Cargile says high-yield bonds can make sense for income-seeking investors, people need to understand they aren't exactly risk-proof. "Concentrate on getting a fair return on the amount of risk you're taking," he says.

**Step it up:** While you're making over your fixed-income portfolio, consider agency bonds, suggests Cargile. Agency bonds are issued by government agencies and government-sponsored entities such as Sallie Mae and Freddie Mac. Like Treasury bonds, they are backed by the U.S. government, but carry slightly more risk, and so offer a higher yield. Keep in mind that agency bonds typically require a minimum investment of \$10,000 to \$25,000.

**An alternative strategy:** buying so-called step-up agency bonds, which are both callable -- that is, the issuing agency can redeem notes at face value prior to maturity -- and offer a fixed interest rate for a period of time. Further, if the issuing agency doesn't call the bond, it will adjust, or step-up, to a new interest rate each year until it reaches maturity. Step-up agency bonds provide a hedge against rising rates, says Cargile. "If interest rates stay low, that bond fund will perform well; if interest rates move up, the step coupon helps us in an interest-rate-rising environment."

Let it float: Another option is floating-rate bonds -- securitized bank loans to companies with debts that rate at or below investment-grade. These debt instruments, which are issued by banks rather than companies, receive greater priority in a bankruptcy proceeding than corporate debt issues. That means if a company defaults, floating-rate bondholders will be paid out before regular bondholders. Currently, floating-rate bond funds yield roughly 6% to 7% and their rates reset every 30 to 90 days, says Charles L. Failla, a financial planner. "As rates go up, they reset every day. These instruments are prime beneficiaries during a rising interest rate environment," he says. Of course, the price for floating-rate bonds could suffer if the economy sags further and corporations start defaulting on bond issues. Essentially, if a company can't pay its debts, investors could be left holding the bag."

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As a general update, the 30 year treasury index (still the most important component in the lump sum calculation) closed on Wednesday, June 22nd, at 4.10%. (finance.yahoo.com). The November, 2009, average completed at 4.32% (20 data points). This number will comprise 40% of the 2010 rate for lump sum calculations. The 2008 rate was 4.52% and the 2007 rate was 4.69%. The Internal Revenue Service has issued new regulations on the new blended corporate rate. The November 2008, rates have three segmented rates, 5.24% (1-5 years), 5.69% (5-20 years), 5.37% (20 years plus). These are the blended rates. All three rates are used in the calculation for the various time horizons. The January, 2010, rates, including the 30 year treasury index, are 4.60%, 6.65%, and 6.76% respectively. The barrel price of crude oil futures, August, 2010 delivery, on the New York Mercantile Exchange is down \$ .25, and is now quoted at \$76.10 (Wednesday, close).

If you know of another co-worker or associate who is interested in receiving these daily interest rate updates, especially #1 which describes how interest rates affect the lump sum (still applicable with PPA '06), please send me an email with their email address so I may add them to the list.

Howard is also a holder of the CRC (Certified Retirement Counselor) designation as well as the ATP (Accredited Tax Preparer) designation. He undertook the requirements for this education to better meet the needs of retirees.

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