DIA Podcast – Interest-Rate Risk (1/13/11 final)

Tip of the *interest* berg? This is Your Money Matters from Diversified Investment Advisors.

Now may be the time to pack your bonds and set sail on the QE2.

No, not the ocean liner. These days QE2 stands for quantitative easing, part two. That's the Federal Reserve's plan to buy up $600 billion in U.S. Treasury bonds by June.

The idea is to give banks more money to lend to each other as well as to consumers … lower today's already low long-term interest rates … and help spur the economic recovery.

Hard to say how well it's been working … or if the economy's been picking up steam on its own.

But one thing seems certain: Today's barrel-bottom interest rates have nowhere to go but up.

Now, exactly *when* and by *how much* is anyone's guess.

What's more important is that while a rising tide may lift all *boats*, rising *rates* tend to sink bond *prices*.

That's because of their so-called inverse relationship – in general, when interest rates rise, bonds prices fall, and vice versa. You can thank the law of supply and demand for that.

Yet even so, not all bonds are alike, and historically, those with the longest maturities have usually had the widest swings. This means rates on newly-issued *30*-year Treasury *bonds* could rise higher – causing their prices to fall farther – than those on *one*-year Treasury *bills*.

And therein lies the risk – that is, the interest-rate risk – many investors face today.

So, what's a retirement saver to do? Here are some tips.

First, stay well-diversified among stocks, bonds and cash … in a mix that make sense for your so-called time horizon and risk tolerance.

Even so, don't lock up long-term savings in a low-yielding bank CD. Instead, save through your retirement plan at work … or with an IRA, where you can move your money around. This way, the yield on your cash won't be stuck in steerage if rates should rise to the upper decks.

Next, stay the course with stocks. Rising rates usually signal a growing economy. And that bodes well for equities.

Last, understand that bonds aren't always the safest port in a storm. True, they can serve as a buoy when stock market waters get choppy. But they face significant risks of their own.

And remember: Prices on the longest-term bonds could fall the farthest if rates rise. So, if you're not in a broad-based mutual fund whose managers have the flexibility to buy bonds of every maturity, consider trading in so-called long bonds for their intermediate-term cousins.

Of course, everyone's situation is different. So before you make any move, make sure to think about your time horizon, risk tolerance and overall financial situation.

Then stick with the basics: Stay diversified, be prudent...and be prepared.

This way, even if the Fed *can't* navigate around the interest-rate icebergs, the band—and your bonds—will play on.

For Diversified Investment Advisors, this is Your Money Matters.

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