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ASK THE **ADVISERS**

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Short-Term Interest Rates

For the first time in a while, people who crave liquidity and safety can earn decent interest on their money. 1-year CDs are paying about 4.5% as of early February. 1-year treasuries are paying 4.79% but 2-year treasuries are paying only 4.3% and 5-year treasuries are paying only 3.67%.

Most investors would instinctively go for the 1-year term, not only because it pays a higher yield than the 2-year or 5-year but because it’s a shorter commitment. Many investors are afraid of commitment. However shorter-term instruments have reinvestment risk.

When a bond matures in a year, no one knows what prevailing interest rates will be at that time; they could be much lower. The inverted yield curve that currently exists (when shorter maturities pay more interest than longer maturities) tells investors and bond buyers the market expects interest rates to drop after a year and even more so after 2 to 3 years. Why is this?

There is a prevailing assumption that, at some point, inflation will come down to the desired level and when that happens the Fed will start to lower interest rates. Remember how interest rates shot up over the last year even before the Fed started raising interest rates simply in anticipation of the fed raising rates in the future? The same thing will happen on the way down.

Rates will fall in anticipation of the Federal Reserve lowering rates in the future before the fed even starts to cut. Therefore, if you are just looking for a safe place to put money and you don’t need the money in the short term it may be wise to take advantage of higher short-term rates for more than just one year.

Highly rated insurance companies are currently offering 3-year fixed annuities that are paying over 5% and 5-year fixed annuities that are paying about 5.5%. Not only do these pay more than Treasuries of equal maturity, they have less reinvestment risk as well.

*Yahoo Finance

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