

Interest Rates Going Down?

When inflation spiked in 2022, the Federal Reserve announced that they would be raising interest rates to combat high inflation. This was an official warning to bond holders that the value of your bonds would be falling even more.

Naturally bond markets will move in anticipation of interest rate movements but not necessarily all the way. Anyone who sold their bonds in 2022 realized some losses from when bond prices peaked in the summer of 2020 but mitigated the additional losses that they would have incurred as interest rates kept climbing.

Now the Federal Reserve has announced that they will be lowering rates this year. The federal funds rate, what banks charge each other for overnight loans, is currently set at a range of 5.25% to 5.5%. The Fed has not decided exactly when or how much the cuts will be, but the bond market is predicting 6 to 7 rate cuts of at least .25% per cut. Goldman Sachs is predicting only 5 cuts which would bring the benchmark down to 4 to 4.25%.

When it became apparent that rate hikes were imminent, smart investors sold their bonds to prevent market losses. Now that it has become apparent that rate hikes are going to rise, it may be smart for investors to lock in higher rates before the Fed cuts rates. In anticipation that rates will be going down, the 10-year treasury yield has fallen from 5% in October to 4% in January. However, currently investors can lock in 6% guaranteed interest for the next 10 years via deferred annuities. When interest rates fall 6% will seem very attractive.

Additionally, there are private preferred stocks with 5-year terms yielding over 7% interest. Finally, there are major banks that are offering structured notes that currently yield 8-9% over the next 5 years if the major stock market indexes are not more than 40% lower when the notes mature in 5 years. As always investment dollars should be allocated to the instruments with the highest risk adjusted returns consistent with one's risk tolerance.

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