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Are Treasurys a Smart Investment in Today's Environment?

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Since 2009, market volatility has sent many investors running to U.S. Treasurys for safety, which raised concerns that a "bond bubble" might be forming. However, investors who understand the dynamics of our current economy might more appropriately compare bonds to a tire with a slow leak – no matter how much you pump it up, it isn't likely to carry you fast or far. Below we will provide an objective look at Treasurys and the alternatives available to those seeking more immediate or reliable yield.

If you rely on your investments for income, being safe and smart means understanding value over time.

What You Should Know:

1. All investments carry risks.

Investments in Treasury debt are widely considered "riskless" from a default standpoint. However, anyone who sells an issue before maturity risks loss of principal.

- Bond prices have an inverse relationship with bond yields, so price erosion occurs when interest rates move higher.
- The only real clarity investors have on the future of rates in the United States is the Federal Reserve's recent guidance, suggesting it will keep rates low until late 2014.

2. "Predictability" and "safety" aren't necessarily the same.

Treasurys have been perceived as a safe haven in times of volatility because their prices don't typically fluctuate as dramatically as equities. However, the real yield on a U.S. bond is its return adjusted for inflation. So if you measure investment safety in terms of actual value over time, consider:

- The 10-year yield on U.S. Treasurys – which stood at just over 2% in early March of this year – reached 1.4% in July.
- Given the current and anticipated rate environment, Treasury investors are looking at negative real yields on the 10-year.

3. **Other investments can help mitigate the risks.**

If what you're seeking is income from your investment portfolio, there are alternatives that your financial advisor can help you understand:

- Callable agency bonds have a preset coupon rate "step- up" that provides for increases in interest or coupon rates as the bonds approach maturity. Step-ups are often called by issuers at a time of declining interest rates, which may accelerate redemption and return principal sooner than expected.
- Floating rate preferreds and fixed-to-floating rate preferreds come with variable interest rates. Floating rate preferreds are generally linked to the three-month U.S. dollar Libor with additional basis points. Fixed-to-floating rate preferreds have a fixed coupon for a certain time period (usually either five or 10 years) and then a floating rate at the end of the period. They are generally linked to the three-month U.S. dollar Libor plus pre-stated additional basis points.

What you should do now:

In today's volatile and uncertain environment, a desire for safety is perfectly natural. But if you rely on your investments for income, being safe and smart means understanding value over time. We recommend you review your portfolio with your Financial Advisor to ensure a proper balance of investments designed to work toward your long-term goals and needs.