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Are Your Fixed Income Investments Appropriate for Your Goals?

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Traditionally investors have viewed bonds as a "safe" investment. This helps explain why, during the global downturn, many moved their assets out of stocks and into bonds. However, the Federal Reserve has been buying $85 billion in U.S. Treasurys and mortgage-backed securities each month to keep interest rates (and, by extension, bond yields) artificially low. This combination of circumstances has introduced more risk into the bond market while leaving many retirement-age investors scrambling to replace diminished income from their portfolios.

It can be easy to get caught up in short-term market fluctuations and make emotional investment decisions.

What You Should Know:

1. Interest rates will go up – eventually.

At its last meeting, the Federal Reserve reaffirmed its commitment to keeping interest rates low until the U.S. unemployment rate drops to 6.5%:

- Unemployment stood at 7.7% at the end of February, before the U.S. Department of Labor's jobs report on March 14 showed a better-than-expected drop in unemployment claims.
- The rate at which interest rates and bond yields eventually increase will depend on several factors, including how the Fed unwinds its current policy and the rate of inflation.
- If interest rates and yields spike too quickly, bond prices could fall rapidly.

2. Even if you aren't selling bonds before maturity, inflation presents a risk.

How long you hold a bond can make a real difference in terms of total return on your investment, especially in a changing rate environment.

- If you buy a longer term bond at today's rates, looking to lock in guaranteed returns, inflation could outpace your returns and make your investment worth less in inflation-adjusted dollars over time.

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- To a lesser extent, investors who keep substantial assets in money market or other cash accounts face similar risks. In today's environment, those returns generally aren't keeping pace with inflation.

3. There are other options for investment income, but many carry additional risks of their own.

Over the past few years, many bond investors have moved assets into high-yield bonds, which can provide greater return in the current environment but carry almost equity-like risk. Examples of investments – both bond- and equity-based – that can potentially bolster portfolio income if you are willing to take on more risk include:

- Corporate bonds
- International bonds
- Dividend-paying blue-chip stocks
- Real estate investment trusts

What you should do now:

Knowing what you hold in your investment portfolio and why you hold it is crucial to both setting your own expectations and reaching them over the long term. If you are investing in bonds to help mitigate risk in a diversified portfolio, you probably shouldn't be reaching for yield in the current environment. And if you are investing in bonds for near-term income, you may want to look at other investment options or revisit your overall financial plan to accommodate the reduced income you're seeing now. In either case, your financial advisor can help you ensure your investments are allocated in a way that is right for your goals and risk tolerance. ■

Fixed income is generally considered to be a more conservative investment than stocks, but bonds and other fixed income investments still carry a variety of risks such as interest rate risk, credit risk, inflation risk, and liquidity risk. In a rising interest rate environment, the value of fixed-income securities generally declines and conversely, in a falling interest rate environment, the value of fixed-income securities generally increases. High yield securities may be subject to heightened market, interest rate or credit risk and should not be purchased solely because of the stated yield. Dividends are not guaranteed and are subject to change or elimination. Investments in real estate investment trusts involves the risk that your investment may be affected by conditions in the real estate industry such as declining properly values or declining rents resulting from general and local economic conditions.

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