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Teeter Totter Of Bonds

We've probably all been on a teeter totter, also called a seesaw. When one side goes up, the other side goes down.

Unfortunately the same concept often applies to taxable corporate bonds, tax-exempt municipal bonds, preferred stocks and other fixed income securities because they are interest rate sensitive.

Whether held individually, in a managed fund, or other packaged investment, they may be affected.

Think of one side of the teeter totter as interest rates and on the other side as the principal value of the investment. When one side goes up, the other side goes down.

There are two basic things to consider in investing. Interest or income is what the investment pays you. Principal is the value of the investment. Sometimes they work in your favor and sometimes they don't.

For the last 30 years or so, long-term taxable bond interest rates declined from the area of 12%+ to 4% or so on fixed income bonds maturing in 20-30 years from their issue date. Like the teeter totter, that means when interest rates went down, bond prices went up. It's a double positive effect. That was good.

But there is the threat at some time in the future that interest rates may be going up for who knows how long which means bond prices are going down. It's a double negative effect. That is bad.

A word tries to explain this. It is called duration. In February 2013, FINRA, the Financial Industry Regulatory Authority, issued an Investor Alert as part of their Investor Education Series.

The two page article was titled "Duration – What an Interest Rate Hike Could Do to Your Bond Portfolio." See www.finra.org and search for duration.

FINRA says that duration signals how much the price of your bond investment is likely to fluctuate when there is an up or down movement in interest rates or inflation.

The higher the duration number, the more sensitive your bond investment will be to changes in interest rates.

As an example, FINRA wrote that a BBB medium investment grade corporate bond with a duration of 14.5 might experience a loss in principal of 26% if interest rates were to rise by two percent from today's low levels.

Remember the stock market and real estate crashes of 2008? The potential future bond market crash might be sadly somewhat similar.

Yet it seems the cost of bread, health care, and most everything are going up in price. So you might wonder about some ways of protecting yourself.

Make sure part of your portfolio has the chance for income growth or lifetime income.

There might be high yielding stocks to consider that pay good income. Frequently, companies raise their cash dividends even though stock prices can go up and down.

You can transfer some of the risk of investing to an insurance company and get a lifetime income.

What does your broker or advisor say about this? Do they just talk about performance and don't bother talking about interest rates and inflation? If so, you may need a second opinion.

Talk to a Financial Planner who might have some ideas to educate you as to your alternatives. Many of them are brokers and advisors who can go the extra step and guide you through this teeter totter problem.

It may be time well spent trying to protect your wealth. If you don't work to protect it, nobody will.

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