ACTIVEFUND STRATEGIES

Rising Interest Rate Denial

It is quite simple. **Rising interest rates produce bond fund losses!**

Especially from such a low point as we had in 2017. In December 2017, Moody's Seasoned AAA Corporate Bond Index posted a yield of 3.51% (**January 2015 offered the lowest return (3.46%) in 51 years (February 1964). Already, in 2018, bond fund values have fallen as much as 6%!**

Rates this low tempt investors to stretch for higher yields, holding their nose to lack of quality, holding their breath to much longer-term maturities or both. The cost could be devastating. Here is a very real hypothetical example of what could happen.

At 3.51%, a $100,000 bond yields $3,510 per year. If interest rates rose to just 8.00%, that new bond would pay $8,000 for the same $100,000 investment, making the 3.51% bond very unattractive. The holder of that lower rate bond would be faced with accepting $3,510 in an $8,000 a year environment or selling the bond to acquire the higher paying bond. But how do you make a 3.51% bond equal to an 8.00% bond? Easy! Sell the 3.51% bond at a discount.

To make a bond paying 3.51% per year magically begin paying 8.00%, the bondholder would simply need to sell the bond for $43,875. That way, the $3,510 annual income would magically equal an 8.00% return ($3,510 ÷ $43,875 = 8.00%).

Stuck with two very unacceptable alternatives, the investor probably stays put, regretting the day he purchased this bond in the face of rising interest rates. And if you don't think we are facing seriously rising interest rates, you just are not paying attention, or you are in denial.

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