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News

Advisors Make the Case for Short-Term CDs, Bonds and Treasury Bills

All three investments, held to maturity, are now available with yields above 2% and little risk.

By Bernice Napach

The rise in interest rates is depressing bond prices but also creating opportunities for investors who have been starving for yield and worried about a stock market correction.

They can now collect more yield in a riskless 6-month Treasury bill than in many dividend paying stocks. The 6-month T-bill was yielding 2.08% as of Friday's close, well above the 1.91% dividend yield of the S&P 500, which has gained just 1.47% year to date. And many one-year CDs are paying between 2.15% and 2.25%, according to Bankrate.com.

"We have been advising clients to get surplus cash into CDs, since we are seeing CD rates north of 2% on 18- to 24-month CDs," says Leon LaBrecque, managing partner and CEO of LJPR Financial Advisors in Troy and Flint, Michigan. "On our individual bond portfolios, we are staying short as well."

David Demming, president of Demming Financial Services, an independent financial planning firm in Aurora, Ohio, noted that two of the firm's favorite hybrid money managers — FPA Crescent and IVA Worldwide, which invest in stocks and bonds — are

now holding about 40% in cash and only about 2% in bonds, rather than usual 20-30%.

"We have, as have most of our asset managers, dramatically shortened our maturities or simply reduced bonds entirely from from our portfolios."

During periods of low inflation, like the last nine post-recession years, bonds have served as a hedge against volatility in the stock market. But now that inflation is rising, the "balance of risk is changing," says Mihir P. Worah, chief investment officer, Asset Allocation and Real Return, at Pimco, who spoke at a recent Fixed Income Market Structure Seminar held by the Securities Industry and Financial Markets Association. "Bonds will not help to hedge equity holdings ... In the absence of a recession there is a negative correlation between stocks and bonds."

But bonds serve other purposes besides hedging equity volatility. They help to preserve principal — they mature at par — and provide income. "Bonds immunize cash flow needs," says Kevin Galvin, director of research and portfolio manager at Hopwood Financial Services in Reston, Virginia. He uses bonds and CDs in client portfolios, holding them until maturity. That locks in the yield and in the case of bonds returns the face value, known as par.

"When the bonds come due investors can take that money to spend. They don't have to sell equities." says Galvin. "That takes the guesswork out of knowing interest rates."

Galvin likes short-duration Treasuries and high-quality short- to medium-term investment-grade corporates rated A or higher. When choosing investment-grade corporates, he looks at the yield pickup over a CD. It should be comfortably higher but not dramatically so. "If there's too much lift that's telling you something ... about where the company or rates are going," says Galvin.

Galvin, like many other financial advisors, builds bond ladders for clients, which is especially useful when rates are rising. The par value of a maturing bond can then be reinvested in a higher yielding bond, often in the same maturity, if the investor doesn't need the cash.

These individual bonds, unlike bond funds and ETFs, have an end date, a fixed maturity and fixed coupon, unlike bond mutual funds or ETFs. Though diversified and highly liquid, bond funds never mature. As a result, they are subject to more interest rate risk than bonds held to maturity.

Paul Mottola
Managing Director
Head of Capital Markets

Individual bonds and ladders of individual bonds are a "very defined planning tool," says Paul Mottola, head of capital markets at Incapital, whose InterNotes platform makes new-issue corporate bonds available for direct purchase by investors. "The simplicity of fixed income securities makes sense in many cases."

Bernice Napach *is a senior writer at ThinkAdvisor covering financial markets and asset managers, robo-advisors, college planning and retirement issues. She has worked at Yahoo Finance, Bloomberg TV, CNBC, Reuters, Investor's Business Daily and The Bond Buyer and has written articles for The New York Times, TheStreet.com, The Star-Ledger, The Record, Variety and Worth magazine. Bernice has a Bachelor of Science in Social Welfare from SUNY at Stony Brook.*

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