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Premium Bonds As a Cushion for Rising Rates.

In the mid-1990s, the United States was emerging from a recession and facing unbalanced budgets, a transition of political party in the White House, and a slower-than-normal economic recovery in the wake of the Gulf War. (Sound familiar?)

I recall discussing the situation and its financial implications with my then business partner as we commuted across the Golden Gate Bridge. More than two decades later, I have a strong sense of Deja-vu as we evaluate clients' financial strategies in light of similar circumstances today.

As fixed income and muni market rates rise, the value of bonds go down. Municipal bond investors have a heightened awareness of the inverse relationship between interest rates and bond prices, but their knowledge of bonds, prices, yields and an extra dose of patience can be an advantage; they understand interest rates eventually will rise again.

For now, the Fed is planning to hold rates at near zero until labor markets reflect more maximized employment and inflation can reach 2% for some time. In this low interest rate environment, more bonds are being issued at premiums for sound reasons, and premium bonds can be used to help stabilize municipal bond values over time – if investors take time to understand them. When purchased correctly, premium bonds can work well in a portfolio and offer reasonable income solutions.

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Nov 26, 2020