What Fed rate hikes mean for retirees

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By **Jeff Benjamin**

With the **Federal Reserve** widely expected to hike interest rates in March for the first of what could be four **hikes this year**, financial advisers will finally have some good news for their retired clients.

As rates slowly move higher, the safest and shortest-term investments, such as certificates of deposit and money market funds, will start to pay higher yields. Finally.

That's the good news.

The bad news is, those short-term rates will likely top out at 1.75% this year, and it will probably be years before Fed policy gets them anywhere near the 4% range that most fixed-income investors crave.

"Our expectation is in a lower-growth environment we'll anticipate a lower than average yields, and lower than average return from bonds in general," said Dirk Hofschire, senior vice president of asset allocation research at **Fidelity Investments**. "The market is expecting a faster pace of rate hikes going forward, but still not a fast pace."

Near zero

Since pushing rates to near zero immediately following the 2008 financial crisis, the Fed hiked a quarter of a percentage point in both December 2015 and December 2016.

A Fed rate-hike cycle, even a meager one, is "potentially good news for older clients, but it depends on how old they are and what level of assets are dependent on interest rates to generate income and value," said Kashif Ahmed, president of American Private Wealth. "We will likely get back to normal in terms of interest rates, but that will take years."

While many retirees, and other investors sitting in the most Fed-dependent fixed-income investments like money market funds, will enjoy slightly higher yields in a rising rate environment, the broader fixed-income market may get more challenging for financial advisers.

Depending on a **bond's duration**, a rising-rate cycle could have a punishing impact on some bond portfolios.

For example, a bond with a five-year duration will decline by five percentage points in the event of a one-percentage-point rate hike.

The reality of bond math is the reason some advisers believe monetary policy has been on such a slow crawl, and will continue to be so.

"President Trump does not want the rates to go too crazy, which is why I think we will get just one hike this year," said Theodore Feight, owner of Creative Financial Design. "But with rates so low, I'm wondering at what level rates will start to have an impact on investor portfolios."

"Retired clients would get hurt badly if we got two or three rate hikes, because most retired clients have a very large amount of bonds in their portfolios," he added.

New cycle

As an illustration of how longer-term bonds often move independently of the Fed's overnight rate, consider that in the months leading up to the **quarter-point hike in**

December 2015 the yield on the 10-year Treasury went from 1.9% to 2.3%.

But as soon as the hike took effect, the 10-year yield began falling toward 1.6%.

"Interest rates move in 30- or 40-year cycles, and we just started a new cycle, so the next 30 or 40 years rates will be going up," said Paul Schatz, president of Heritage Capital Management.

"It won't be a good time for most fixed-income investors for a while," he added. "You get better yields but your principal keeps declining, and the only way to deal with that is a basic **bond ladder.**"

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