

Commentary (/commentary/)

# Making the most of low interest rate environments

Interest rates will eventually rise and when they do, retirement savers will want to be sure that they have diversified their portfolios

By **Doug Wolff** | November 12, 2020 at 10:54 AM

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Owing to the economic uncertainty brought on by COVID-19, the Federal Reserve has indicated that it doesn't expect to make any increases in the Federal Funds Rate through 2023, possibly even longer.

At these current low rates, retirement savers, especially those who tend to be on the more conservative side, are making do with negligible yields, but these low-risk, low-return options aren't generating the desired results. However, there are several low-risk, high-reward type products and strategies that can help even the most conservative of retirement savers balance short-term needs with long-term savings-preserving principal and still participating if rates rise.

## Laddering

While shifting markets can be intimidating to many, strategically aligning for a changing shifting market can lend an advantage in the long term. Laddering is one such creative strategy.

As interest rates vary, laddering can be used to create a diverse portfolio of different maturities that aren't locked into a universal rate. Shorter-term instruments like CDs and money markets form the base of the ladder and provide liquidity, allowing individuals to purchase new holdings with higher rates should rates increase. This may provide an advantage in shifting markets, as they can assist those looking to access their funds following a potential market recovery, for example, allowing them to reinvest in other ways.

Assets with longer maturities typically offer higher rates and form the top of the ladder. Fixed and fixed indexed annuities can be used here for more competitive rates and as bond or bond fund alternatives.

## **Making the most of CDs and annuities**

Using CDs and annuities to further diversify and complement existing portfolios is also a prudent strategy. While annuities and CDs may differ in features, bundling them into an existing portfolio can be effective.

CDs allow for immediate access to funds in need of an expenditure or emergency funds, whereas annuities serve as the stable alternative to facilitate a longer-term goal at potentially higher interest rates. What's more, annuities accumulate interest tax-deferred.

As noted, annuity products can also be used as bond alternatives. Take for example, fixed index annuities (FIAs). When interest rates go up, the market value of an FIA does not change, whereas bond and bond fund prices tend to drop as yields rise. This is more protection against potentially rising interest rates.

When used together, CDs and annuities help to balance short-term needs with long-term savings.

## **Floating rate options**

Floating rate annuities are another option in the existing rate environment that may help overcome the pressures of a low-interest rate environment.

Instead of tying the annuity to a fixed rate, floating rate options tend to tie credited interest to a combination of the market rate and LIBOR or SOFR, which closely track the direction of the Federal Funds Rate. Fed Funds movement, up and down, is based on current and projected economic conditions and also by major events.

The Federal Reserve generally changes rates in a systematic manner over an extended period. So if rates begin to rise in the next couple years, and continue upward, a floating rate option could help provide some protection by automatically adjusting to the new rate levels.

## **Many opportunities**

Market shifts can be intimidating, but there are many opportunities to try to make the best of shifting interest rates and market volatility, and sometimes doing so requires some creativity and planning.

COVID-19 has certainly shaken things up. However, interest rates will eventually rise and when they do, retirement savers will want to be sure that they have diversified their portfolios in seeking to: make the most of the current environment for one, and to keep an eye on potentially maximizing yields in an eventual rising rate scenario.

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