Key Questions

November 29, 2023

# If the Fed is Done Raising Rates, Should I Buy Bonds?

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The Key Wealth Institute is a team of highly experienced professionals from across wealth management, dedicated to delivering commentary and financial advice. From strategies to manage your wealth to the latest political and industry news, the Key Wealth Institute provides proactive insights to help grow your wealth.

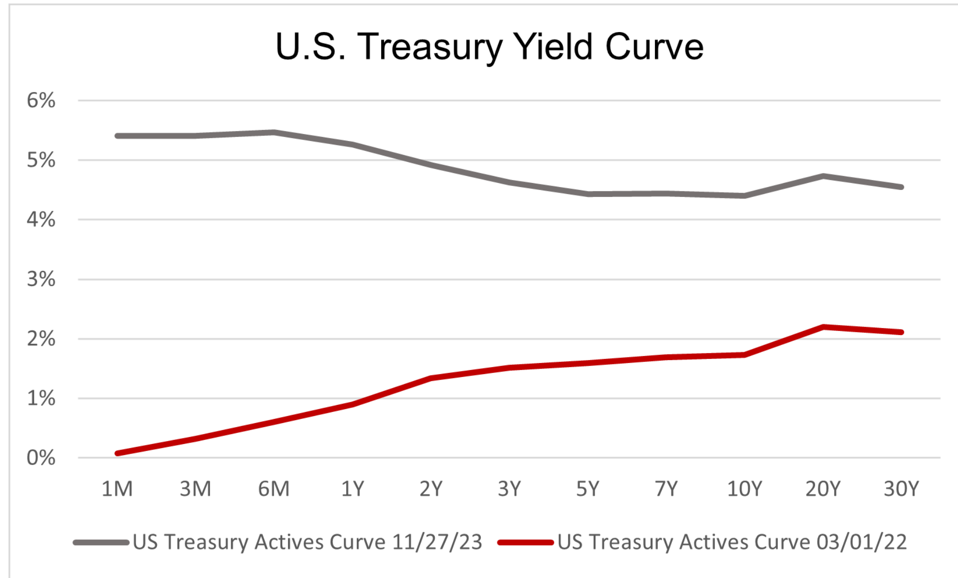
Since March 2022, the Federal Reserve (the Fed) has raised short-term interest rates by 5.25%, a considerable amount. But now, the bond market is signaling that the Fed is potentially nearing the end of its tightening cycle. As a result of this dramatic increase in interest rates, investors have flocked to traditional safe havens, such as money market funds and short-term Treasury bills, which are both yielding above 5%, the highest levels since December 2000. If the Fed were to change course and begin to lower short-term rates, bond investors might quickly lose an opportunity to lock in longer term maturities now and to secure yields we have not seen in two decades.

Varied opinions on Fed policy, which dictates interest rates on the front end of the yield curve and more broadly the shape of the yield curve, have the market waiting for more information on the timing and direction of interest rates. Recent volatility in rates has also caused apprehension on whether the time is right to deploy cash into fixed income solutions. Timing the market is extremely difficult to do, and timing the market consistently is nearly impossible, so we would discourage any attempt to do so. Determining the right time to invest in fixed income markets can be a challenge even for veteran fixed income investors.

For beginners, fixed income can be a great way to diversify your portfolio, but finding the right product within a world of Treasury, agency, corporate, or municipal bonds can be daunting. It is important to consider your investment objectives, tax implications, and risk tolerance before making any decision regarding your asset allocation, as fixed income products vary by tax treatment and credit worthiness. Understanding what role specific bonds can play within an investment portfolio is critical to tax-efficient investing, and investors would be wise to consult their advisor for specific recommendations tailored to his/her unique circumstances.

Those with existing bond holdings have experienced a great deal of pain during this Fed cycle, as interest rates and bond prices have an inverse relationship with each other. As yields have dramatically moved higher, bond prices have moved lower. So, like dollar cost averaging in stocks, we look at this correction as a potential opportunity to add to existing bond holdings and/or extend maturities to lock in these higher yields for a longer holding period. Additionally, current bond holdings with unrealized losses can be sold to offset gains in other areas of a portfolio with capital gains, mitigating some of the damage caused by the move higher in rates.

The Fed policy decisions to raise short-term interest rates to curtail inflation have created an inverted yield curve in which interest rates on shorter maturities are greater than longer maturities. People have been generally content collecting 5% in money markets or short Treasury bills, especially since investors were willing to accept near zero a few short years ago. The problem arises when the Fed pauses or pivots from their current tightening policy and those short bonds mature or money market rates drop.




Will people accept a lower return from short bonds? This could potentially be the right time to start to put idle cash to work and/or extend short maturities to buy longer dated bonds if you believe that the Federal Reserve is nearing a change in policy.

There is still a great deal of volatility in the bond market right now, and so we would certainly recommend a thoughtful approach with the help of a KeyBank investment advisor in developing an appropriate fixed income strategy. Time in the market can be more important than timing the market, and we would advocate investigating this opportunity to see how fixed income can benefit your portfolio.

For more information, please contact your advisor.

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