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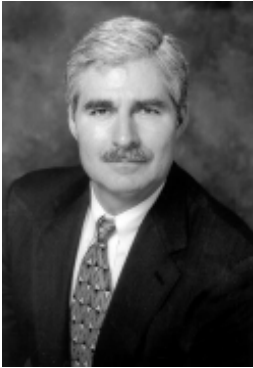
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Investment Corner

Strategies, Secrets and Common Sense

How to Take the Guesswork out of Interest Rates

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Are you one of the millions of CD investors who is still suffering from low-rate sticker shock? The low interest rate

environment we have experienced is great for refinancing your home but painful when it comes to achieving safe returns on your investment dollars. The timing and extent of an interest rate move has captured the attention of the media and most financial experts as well as the investing public. Unfortunately, even the experts can't get it right.

Twice each year the Wall Street Journal surveys the nation's top economists for their six-month predictions on the economy. They ask for their forecasts on several topics including the future level of interest rates. One University of Michigan study on the accuracy of this panel was quite startling. The study spanned 16 of these time frames, a period of eight years. The results? Only four times out of 16 did the economic experts even forecast the right **direction** for interest rates. You read that correctly: they could not even predict whether interest rates would be higher or lower in six months. If this is an accurate study, you might ask the following question:

How can the average investor take the guesswork out of investing in fixed income?

The answer requires an honest assessment of two facts. Fact one is that no one can consistently predict the movement of interest rates. Fact two requires a history lesson. Reviewing interest rate levels for the last 75 years provides the first clue to designing an investment portfolio. The study examines **return efficiency**. **Return efficiency** examines what maturity levels provide the most return with the least risk. This measurement is reflected in what is known as a yield curve.

The yield curve is a graph that measures rate of return for time invested. Logic would suggest that the longer your money is invested, the higher the return you should receive. This is known as a "traditional yield curve." In the early 1980's, the days of the double-digit CD returns, we had an "inverted yield curve" when short-term rates soared higher than long-term rates. A study of historic returns shows that five and ten-year maturities return on average 90% and 95% of the 30-year treasury bond with considerably less risk, whether rates were 10% or 3%. Translation: the five and ten year bonds provide the most **return efficiency**.

But what about the unpredictable nature of interest rates? If money was invested in the 5 - 10 year time frame and rates expanded significantly one or

two years from now, then you would have no funds available with which to take advantage of the new higher rates. The answer is the "laddered" or "stepped" maturity portfolio. An illustration is on the reverse page of this article.

The way it works is quite simple. Take the funds that you have to invest and invest 1/10 each year for ten years. When your bond or CD matures at the end of the first year, invest it out ten years. Continue this process each year, rolling the matured bond to the next ten-year cycle. When the fourth year arrives, your new one-year bond is your original five-year bond and you will have completed the process of maximizing **return efficiency** because all of your investments will have been made at the most attractive historical levels. This approach works using all investment instruments including CDs and tax-free municipals. An added benefit is the potential pay raise you receive each year as you shift more and more of your assets to the higher yielding bonds. You cannot control whether rates will be at 3% or 10% but you can take advantage of owning the most historically effective maturity levels regardless of the rate.

How do you take the guesswork out of interest rates? Don't guess. Embrace an intelligent approach based on factual trends that will provide stability to your fixed income portfolio and peace-of-mind to the management of your most conservative assets.

Stepped Maturity \$100,000

<u>YEAR</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
PHASE 1												
AMOUNT	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000
YIELD	1.8%	2.7%	3.5%	3.9%	4.3%	4.5%	4.9%	5.0%	5.2%	5.6%	5.6%	5.6%
INCOME	\$175	\$270	\$350	\$390	\$430	\$450	\$485	\$500	\$520	\$560	\$560	\$560
PHASE 2												
AMOUNT		\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000
YIELD		2.7%	3.5%	3.9%	4.3%	4.5%	4.9%	5.0%	5.2%	5.6%	5.6%	5.6%
INCOME		\$270	\$350	\$390	\$430	\$450	\$485	\$500	\$520	\$560	\$560	\$560
PHASE 3												
AMOUNT			\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000
YIELD			3.5%	3.9%	4.3%	4.5%	4.9%	5.0%	5.2%	5.6%	5.6%	5.6%
INCOME			\$350	\$390	\$430	\$450	\$485	\$500	\$520	\$560	\$560	\$560

EXPLANATION OF PHASES:

PHASE 1: The \$100,000 is invested equally over 10 years. **PHASE 2:** The \$10,000 maturing in 2005 is invested in the 2015 maturity. **PHASE 3:** The \$10,000 maturing in 2006 is invested in the 2016 maturity. **PHASE 4-10:** Each year the \$10,000 maturing is invested in the next 10 year bond.

ANNUAL INCOME REVIEW:

Each year the income of the portfolio increases as the lower yielding short bonds are replaced with higher yielding 10 year bonds.

PHASE 1	\$4,130											
PHASE 2		\$4,515										
PHASE 3			\$4,805									
PHASE 4				\$5,015								
PHASE 5					\$5,185							
PHASE 6						\$5,315						
PHASE 7							\$5,425					
PHASE 8								\$5,500				
PHASE 9									\$5,560			
PHASE 10										\$5,600		

Assumptions for this illustration: 1. \$100,000 available for Investing 2. Interest rates remain constant for illustration

The information contained herein is derived from sources believed accurate but not guaranteed. Prices, yields and availability will change with market movement. Source: Fixed Income Securities