

## TIME TO TAKE AN INTEREST IN RISING INTEREST RATES

It was only a tiny change – a quarter of a percentage point. But it signaled that it's time for consumers to start paying closer attention to rising interest rates and make adjustments in how they manage their personal finances.

At the end of June, the Federal Reserve raised its federal funds rate – what banks charge each other for overnight loans – from 1 percent to 1.25 percent. The prime rate, which affects consumer loans and small-business loans, went from 4 percent to 4.25 percent.

The rate hike was the first in four years by the Fed – a period that saw short-term rates drop from 6.5 percent to 1 percent. While small in itself, the hike may foreshadow what experts believe will be a series of modest rate hikes over the next 12 to 18 months to dampen the risk of inflation. In response, consumers and investors need to think about how they might adjust their spending habits, their portfolio, or even their financial goals.

**Borrowers beware.** Many borrowers will be among the first to feel the impact. Consumers who have run up large balances on variable-rate credit cards and home equity lines of credit will see rates tick up soon, forcing them to pay more out of pocket to borrow. The advice is pretty straightforward here, say financial planners: pay down as much of this kind of debt as possible by cutting other expenses or by finding ways to boost income.

You also may want to consider consolidating debt, such as transferring higher-rate credit card balances to lower-rate home equity loans, which, while going up, won't cost nearly as much as credit cards. Just keep in mind that you're putting your home at greater risk (credit cards are unsecured loans).

The impact of rising interest rates on home mortgage loans sparks a little more debate. Some planners think that homeowners can continue to use adjustable rate mortgages, which have become very popular because they're lower than fixed rates.

But the decision rests in part on how long you intend to live in your home. If it's fewer than ten years, ARMs may still be OK, though be sure to look carefully at their annual and lifetime caps for rate increases. Some advisors recommend ARMs that have fixed rates for the first three to ten years of the mortgage before it readjusts to the floating interest rate. But if you plan to live in the house longer than ten years, it might be worth locking in a standard fixed-rate mortgage, which, though higher than ARM rates, is still low.

**Savers aren't salivating yet.** Higher interest rates aren't good news for borrowers, but savers and retirees with money in certificates of deposit, savings accounts, and money markets are cheered – sort of – by the higher rates. That's because interest rates for these types of accounts have been abysmal in recent years, with many of them dipping below one percent.

Still, it's somewhat of a mixed blessing. Rates are still low compared with rates that once hit double digits. The other mixed blessing is that the major reason the Fed has started raising rates again is to drive a wooden stake through inflation before it starts roaring – and inflation is never good news for retirees living on fixed income.

**Investors need to investigate.** Modest inflation resulting from an expanding economy is often a good sign for stock market investors. High inflation is not. The more immediate concern for investors, say many planners, involves bonds.

Many bond investors don't realize that when interest rates rise, bond prices decline, and the longer the maturity of the bond the faster the decline. Sell before the bond matures, or be invested in bond funds where they can't control bond sales, and they'll likely lose some of their investment. Many planners are recommending that investors shorten the maturity of their overall bond holdings, allowing the flexibility to reinvest as rates climb.

Another potential investment area to consider is commodities – oil and gas, gold, timber, agricultural products. Investors should always consider commodities in a portfolio as a good diversification asset – but commodities tend to do especially well during inflationary times.

Even if interest rates continue to climb, say some planners, don't panic. If the Fed continues making modest increases, it's likely because the economy is expanding, and that's good for everyone.

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