An Interest Rate Menagerie

By Russell Wild *Sun, Apr 14, 2013*

As an advisor, I'm trying to delicately balance the advice of both Malkiel and Bernstein by squeezing out a bit of extra yield—just a bit—without taking undue risk.

The Academy-Award winning film *Life of Pi* featured a fantastical story of wild beasts battling amongst themselves while adrift on a lifeboat after their ship goes down in a storm. Today's politicians, pundits and investment advisors are battling amongst themselves over whether an interest-rate storm is coming, and how to build and stock an appropriate lifeboat for such an event.

Some argue we should try to stall the storm as long as possible. Times like these, they say, with unemployment high and businesses skittish to invest, call for as loose a monetary policy as possible to keep rates from rising. In *The New Yorker* last week, James Surowiecki said the broader good of low interest rates clearly trumps the dampening effect of low interest rates on savings accounts, CDs, and savings bonds. His column was entitled, "Shut Up, Savers!"

Others (name any Republican in Congress or presidential-hopeful) argue that the Federal Reserve's efforts to keep interest rates low are throwing our seniors to the wolves (or tigers or hyenas), forcing them to accept pitifully low interest rates on their savings, and chewing them up alive (like the meerkats in *Life of Pi*). Some go so far as to suggest that low rates are forcing seniors back to work, and so stealing employment from the young. We must, for the sake of everyone, they argue, allow interest rates to rise.

In a recent article in the *New York Times* ("A Debate in the Open on the Fed," April 2), it was made clear that even officials within the Federal Reserve don't agree over how to handle this stormy question of what to do about interest rates.

Martin Feldstein argued in an April 1 guest column in this publication that regardless of government policies, regardless of what we *want* to happen, economic forces will eventually force interest rates up. Others, like bond guru Jeffrey Gundlach, have argued that nothing is inevitable—and that interest rates may stay low for a very, very long time.

This uncertainly has created yet more battles about what to do in the interim, while we're waiting for interest rates to bolt—or not.

Some investment advisors say that we can't sit by and watch inflation consume our savings. We should sift through the world of fixed income offerings, seeking yield in strange and usual places, like floating-rate bonds. Burton Malkiel suggests a good look at emerging-market bonds. Some say we should lower our fixed-income allocations along with our expectations, and beef up our allocations to dividend-paying stocks, and REITS.

Other notables of the investing world, such as William Bernstein, argue that we should play it safe. He recommends high-quality, short-duration bonds, even if it means losing out to inflation, so that we can stay on top of the water once the waves of higher interest rates start to smack us hard.

In the *Wall Street Journal* last week ("Pay Off That Mortgage Now!" April 6), columnist Brett Arends argued that it may not make sense to hold bonds at all. We should trash the bonds and pay off our mortgages, he says. Others have argued strenuously that this is the best time ever to *lock in* on low-hanging mortgage rates.

All told, the controversy over what we should do about interest rates, as both a matter of both public policy and as investors, is one of the hottest controversies of the era… and not one to be solved anytime soon. As for as public policy goes, I'm in the let's-stall-as-much-and-as-long as possible group. As an advisor, I'm trying to delicately balance the advice of both Malkiel and Bernstein by squeezing out a bit of extra yield—just a bit—without taking undue risk. On the debt front, I'm all for taking on long-term mortgages and not liquidating our bonds. It'll pay in the long-run. Maybe.

Of course, my story is one of many. As protagonist Pi said at the end of the movie about the wild beasts, many alternative stories can be told about storms and lifeboats and survival. You get to choose the one you prefer.

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