

# For ‘Safe’ Investors, This May Be a Challenging Year

By [JEFF SOMMER](#)

MONEY market funds are paying investors next to nothing.

More precisely, the 100 biggest funds are now paying 0.05 percent annually, on average, a yield as low as it has ever been, according to Peter G. Crane, the president of Crane Data of Westborough, Mass.

“It’s so low it’s a joke,” Mr. Crane said. “At that yield, it would take more than 1,000 years to double your money.”

This microscopic rate of return is part of the continuing fallout of the [financial crisis](#) — a consequence of the very loose monetary policy of the [Federal Reserve](#) and other central banks. They have held their benchmark short-term rates at rock-bottom levels while using unorthodox methods, known as “[quantitative easing](#),” to restore the health of the global financial system.

There are many indications that this herculean intervention has been working. In the bond market, though short-term interest rates are still hovering near zero, longer-term rates have been on an upward trajectory since late November. In part, this may be a healthy sign, suggesting that the economy is recovering. But it has also created a very unusual situation for financial markets, and it poses some tricky problems for savers, investors and home buyers.

First, how unusual is the current array of interest rates?

[William H. Gross](#), the co-chief investment officer of the Pacific Investment Management Company, or Pimco, the world’s biggest bond manager, says the gap between short- and long-term rates has rarely been greater. Translated into the parlance of the bond market, the “yield curve” has seldom been steeper.

“If you go back in history and look not just in the United States but in global fixed-income markets for several centuries,” Mr. Gross said, you will rarely find a greater disparity between short- and long-term rates.

For investors, this can create some hard-to-resist temptations.

People who have been holding cash in money market funds or in bank certificates of deposit, for example, may be yearning to buy longer-term bonds instead. [United States Treasury](#) bonds with 30-year maturities, for example, yield about 4.5 percent; 10-year Treasuries yield about 3.8 percent. These rates are modest by historical standards but are much more attractive than the negligible yields available in the money markets.

Watch out, though. Liquidating investments that pay almost nothing in order to shift to long-term bonds that pay substantially more may not make sense right now, said Robert F. Auwaerter, the head of fixed-income investing at the Vanguard Group.

“Right now, investors need to be thinking about interest-rate risk,” he said. The problem is that interest rates — at both the short and the long ends of the yield curve — are likely to rise this year if the economy keeps expanding.

When bond yields rise, their prices fall. The effect is magnified for longer-term securities, so a 30-year Treasury bond would fall in value much more sharply than, say, a six-month Treasury bill. A money market fund would benefit as interest rates rise.

“In this environment, I’d be very careful about buying long-maturity bonds,” Mr. Auwaerter said.

On the other hand, homeowners and people looking to refinance mortgages might be advised to move now, rather than wait for the markets to settle further. An increase in mortgage rates, which are closely linked to bond yields, is widely expected this year. Furthermore, the mortgage market has been actively supported by the Fed’s \$1.25 trillion dollar program to buy asset-backed securities. The Fed has said that it intends to end that program at the end of March, though an extension is possible.

Vanguard estimates that 30-year fixed mortgage rates could rise by a quarter to a half percentage point simply as a result of the end of the Fed program, Mr. Auwaerter said. An additional increase could be expected if bond yields rise further. Mr. Auwaerter and other analysts say long-term yields are expected to keep rising modestly, and for several reasons: inflation expectations are rising, Treasury sales of long-term bonds to finance the deficit are projected to be greater than ever, and Fed purchases of [Treasury securities](#) are expected to decline.

The average rate for a 30-year fixed mortgage was 5.18 percent last week, according to [Bankrate.com](http://Bankrate.com). It is likely to rise above 6 percent by year-end, Mr. Auwaerter said.

Of course, projecting the direction of interest rates requires a judgment about the economy. At the moment, housing “is a real wild card,” said Steven C. Huber, manager of the Strategic Income fund at [T. Rowe Price](http://T.Rowe.Price). To prevent the housing market from weakening further, he said, the Fed is likely to unwind its mortgage support program gradually. And he said the Fed was unlikely to raise short-term interest rates until the unemployment rate, now 10 percent, was back in the 9 percent range.

STILL, many analysts project that the Fed will raise its benchmark Fed funds rate, bringing it to perhaps 1 percent by year-end. In the same period, the yield on the 10-year Treasury note may rise well above 4 percent, Mr. Gross said. And because of long-term structural deficits in the United States, he said, Treasuries may underperform the sovereign debt of some other countries, like Germany.

For individuals focused on keeping their investments very safe, it’s likely to be a challenging year.

“Basically, savers are going to have to suck it up,” said Mr. Crane at Crane Data. “Yields are so low that they’re getting almost nothing in return, but this is not a time to play offense. Remember, if you’re holding a money market fund or a C.D., you’re there because you don’t want to lose money. This is not the time to take a lot of risks.”