# Rising interest rates: What they mean for your portfolio

As many market watchers expected, the U.S. Federal Reserve (Fed) raised its key policy interest rate by 0.25% in December 2016. The Fed also indicated that there would likely be additional hikes in 2017.

Let's look at what this may mean for your fixed-income portfolio and how we can help position it for success through various market events.

### How do rising rates affect bonds?

When central banks raise key interest rates (the federal funds and discount rate in the U.S., the overnight rate in Canada), the move affects the bonds you currently hold. Some bonds, however, are impacted more by interest rate increases than others.

When key interest rates move higher, the current market value of existing bonds declines, with short-term bonds declining less than longer-term bonds. Short-term bonds are generally less sensitive to key rate moves.

This difference in sensitivity occurs because your money is committed for a longer period of time with a long-term bond. You have to wait longer for the bond to mature, receive the principal back and re-invest it at the new, higher rate. In effect, bonds with longer maturities are locked in at a lower rate for a longer period of time.

Keep in mind that if you hold a bond to maturity, the face value of the bond is returned to you (except in the case of default). In this discussion, we are talking about a decline in value that can occur when you sell a bond prior to its maturity date.

**Resource:** Experts from CIBC Asset Management provide insights on a rising-rate environment. Watch video…

### Protect your fixed income portfolio

As the most recent U.S. interest-rate increase has reminded us, the marketplace is not stagnant; it will always fluctuate. Here are some investment options that can help you best position your portfolio to take advantage of market movements.

*Corporate investment-grade bonds:* These are issued by high-quality corporate borrowers and are less sensitive to interest-rate movements than government bonds. These bonds typically have a very low risk of default and can modestly enhance yields with little added risk.[1]

*Floating-rate notes:* Like conventional bonds, floating-rate notes have maturity dates. However, the coupon (a bond's interest payment) is tied to a benchmark like the Canadian Dealer Offered Rate (CDOR), Canada's version of the London Interbank Offer Rate (LIBOR). The coupon is adjusted every month or every quarter. Because of this reset, floating-rate notes benefit by paying higher coupons almost immediately when interest rates rise.[2]

*High-yield bonds:* These are high-paying bonds with lower credit ratings than investment-grade corporate bonds, treasury bonds and municipal bonds. They are issued by smaller, unproven corporations or larger companies that have high debt ratios. High-yield bonds are less impacted by changes in key interest rates than most other fixed income vehicles.[3]

*Fixed income mutual funds:* These are mutual funds that invest in a variety of bonds. Remember that even if the fund's net asset value falls, the bonds within the fund should continue to make the stated interest payments. The good news is that when the bonds within the fund mature or are sold, they can be replaced with higher-yielding bonds. This could create more income in the future. Additionally, when reinvesting mutual fund distributions back into the fund, there may be a benefit from purchasing additional mutual fund units at lower prices.[4]

**Benefits of holding dividend-paying stocks**

Dividends are a portion of the profits some companies may pay to their stockholders. Dividends can provide you with an alternative revenue stream. They can also help increase the return that may be realized from selling your shares in a rising market.

**Importance of diversification**

Diversifying your portfolio can help protect your capital despite market swings and interest-rate fluctuations. It's one of the best strategies to help you achieve your long-term financial goals. We can help you position your portfolio for success by:

- **Choosing a variety of investments** such as cash, stocks, bonds and mutual funds.
- **Selecting investments** with different risk profiles to help ensure that losses in one area are offset by gains in other areas.
- **Varying investments by industry** to help minimize the risk of being exposed to only a small group of companies that are all affected by the same economic events.

*Market changes are a part of investing. If you have any questions about your investment portfolio or the markets, we're here to help. Contact us to review your investments and make sure you are on track to meeting your financials goals.*

1 *http://www.moneysense.ca/save/investing/gic/how-to-squeeze-out-more-yield-from-your-fixed-income/*

2 *http://www.moneysense.ca/columns/understanding-floating-rate-notes/*

3 *http://www.investopedia.com/terms/h/high_yield_bond.asp#ixzz4U3eavn9N*

4 *http://articles.chicagotribune.com/2013-06-19/business/sns-201306191630--tms--retiresmctnrs-a20130619-20130619_1_interest-rates-short-term-bonds-bonds-drops*