What rising interest rates mean for your fixed income portfolio

Over the past two years, the Federal Reserve rose interest rates at a rate not seen since the 1980's, leading to some of the worst years for bond investors in history. During October 2023, the US Treasury 10-Year yield breached 5% for the first time since 2007, a significant increase from the 0.6% yield experienced during the height of the pandemic. Rising interest rates have a significant impact on a fixed income portfolio: as interest rates increase, bond prices typically decrease, which can lead to capital losses for bondholders. This is because when interest rates rise, new bonds are issued with higher yields, making existing bonds with lower yields less attractive to investors.

It is important to note that not all fixed income securities are equally affected by rising interest rates. For long-term bonds, the impact of rising interest rates can be more severe. This is because the longer the maturity of a bond, the more sensitive it is to changes in interest rates and the value of a long-term bond can decline significantly as interest rates rise. However, short-term bonds, such as Treasury bills, are generally less sensitive to interest rate changes and can provide a degree of stability in a fixed income portfolio.

To help protect their fixed income portfolio against the negative impact of rising interest rates, investors have a few options:

- First, investors can consider purchasing floating rate securities, such as floating rate bonds and bank loans, that provide a hedge against rising interest rates. This is because their coupon payments adjust with changes in interest rates, so when interest rates rise, their coupon payments immediately rise as well.
- Investors can also consider laddering their bond portfolio, which involves investing in bonds with a range of maturities. This strategy can help mitigate the impact of rising interest rates, as the bonds in the portfolio will mature at different times, providing a steady stream of income and capital gains.
- Finally, investors can buy individual bonds and hold them to maturity, eliminating the market volatility associated with the day-to-day value of the bond. However, this strategy will require more due diligence and monitoring than buying a bond fund.

It is also important to remember the positive impacts of rising interest rates for fixed income portfolios. As interest rates rise, bond yields increase, providing a higher level of income for the bondholder. Higher interest rates provide investors with an opportunity to purchase long duration bonds to lock in a higher yield.

Rising interest rates can have a significant positive and negative impacts on a fixed income portfolio. However, by considering a range of strategies, such as investing in short-term and floating rate securities, laddering a bond portfolio, and holding bonds to maturity, investors can help mitigate the impact of rising interest rates and potentially even benefit from them over a full economic cycle. Please consult your wealth advisor to ensure what investment strategy is best for you.

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