Mesirow

Are I Bonds still a solid investment choice?

Series I Savings Bonds, or "I Bonds," emerged as a popular vehicle in 2022 due to the highest inflation levels since the 1980s. While inflation remains relatively high, it is prudent to challenge if I Bonds are still an appropriate savings vehicle going forward.

What are Series I Bonds?

Series I Bonds, or “I Bonds," are savings bonds from the United States Treasury that encourage Americans to save for the future while protecting their savings from inflation. 1

The fixed and variable interest rates are announced every year on May 1st and November 1st. The fixed rate stays with the bond for the duration of its life, while the variable rate changes every six months, with the change in inflation driving the variable interest paid.

The interest from the I Bond is earned monthly and compounded semiannually. Interest is then added to the bond’s principal and paid out when an investor cashes in the bond or it reaches maturity.

Pros

- I Bonds are generally a liquid investment and can be held for as little as one year and as long as 30 years.
- They are viewed as a lower-risk investment and have been known to achieve a relatively high yield during high inflation.
- I Bonds are taxed at the federal level, but not the state or local level
- In some instances, trusts, estates, and business entities can purchase I Bonds

Cons

- If an I Bond is sold before five years, a penalty of 3 months' interest is applied. They cannot be sold within one year of purchase. So, for example, if a bond is sold after 18 months, only 15 months interest will be received.
- I Bonds can only be purchased atTreasuryDirect.gov
- There is a limit of $10,000 per year per SSN, with an option of purchasing an additional $5,000 (per Social Security Number ("SSN") if using an income tax refund. Theoretically, a married couple can invest up to $30,000 per year if they have a $10,000 tax refund

Challenging I Bond viability

The current interest rate on an I Bond is 5.27%. That may seem attractive compared to interest rates offered on savings accounts through large commercial banks. However, that rate is only guaranteed for the first six months that you hold the I Bond. The yield for the next six-month period is repriced based on the percentage change in the Consumer Price Index for all Urban Consumers ("CPI-U"). To repeat, even if inflation remains high from an absolute standpoint, if the change in CPI-U is de minimis, you could lock in a relatively low interest rate for the next six-month period.

Here is an example:

- Purchase $10,000 in I Bonds
- Interest first six months: 6.89%
- Interest second six months: 1.00%
- Total interest after selling I-Bonds after one-year (the soonest you are permitted to sell): $394.50
- Less $50: three-month interest penalty for selling before holding for five-year period: $344.50

- One-year yield (pre-tax): 3.45%

Compare that yield to a one-year Treasury Bill ("T-Bill"), which offers immediate liquidity and a current yield to maturity of approximately 4.82%.

I Bonds offer tax reporting flexibility

Depending on your situation, you have a few options for reporting the interest incurred during the life of the bond:

- You can report the interest earned every year when you file your taxes
- You can defer reporting the interest until you file a federal income tax return for the year in which the first of these events occurs:
  - You cash the bond and receive what the bond is worth, including the interest, or
  - You give up ownership of the bond, and the bond is reissued, or
  - The bond will stop earning interest because it has reached final maturity

How to purchase

An I Bond purchase may still be appropriate depending on the forward-looking view on inflation that you and/or your advisor holds. To purchase an I-Bond, follow the prompts detailed through this link: https://www.treasurydirect.gov/indiv/research/indepth/ibonds/res_ibonds_ibuy.htm.

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1. https://www.treasurydirect.gov/indiv/research/indepth/ibonds/res_ibonds.htm