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2010 RETIREMENT GUIDE



RETIREMENT

Fixed income alternatives for retirees

By Dan Weil • Bankrate.com

With paltry interest rates on money market accounts and funds -- and yields on [certificates of deposit](#) not much better -- retirees are looking for safe alternatives.

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"We're getting a lot of questions about that," says James Holtzman, a shareholder at Legend Financial Advisors in Pittsburgh.

He and others recommend an array of alternatives that improve yield, ranging from short-term government bond funds to utility stocks. But keep in mind that while many investments offer a higher return than money market funds and short-term CDs, virtually none of them offers as much safety.

"When you move from money markets, risk increases. That's the first thing you have to keep in mind," says Tim Chriskey, chief investment officer at Solaris Asset Management in Bedford Hills, N.Y.

Bonds

Bonds are probably the first place you'll want to look, as their returns beat money market accounts and funds with more safety than you get in stocks.

The risk with bonds -- also known as fixed-income investments -- is that when interest rates rise from their historic lows, bond prices can fall. Remember that bond prices move in the opposite direction of interest rates.

"The environment for the fixed-income market over the next several years is likely to be very different than the past 10 to 20 years," says Michael Sheldon, chief market strategist for RDM Financial Group in Westport, Conn.

"These are the lowest interest rates we've seen in a generation. So it's logical that rates can only go in one direction from here, namely higher."

Legend Financial recommends a short-term adjustable-rate government bond fund for some of its clients. Short-term bond prices decline less than long-term bonds when interest rates rise. Adjustable-rate bond funds can offer more stability in dividends and share price than fixed-rate bond funds. And government bonds are safer than corporate bonds.

Given the risk of higher rates, Holtzman says retirees should consider putting just a portion of their cash reserves into this type of fund. "You hear about keeping six months of your spending needs in cash reserves," he says. "Maybe put one to three months of it in a fund like that."

Treasuries, munis and corporates

A Treasury bond or Treasury bond fund will offer you the most safety in the fixed income market. Unless the federal

government goes bankrupt, you can rest assured that the bond's principal and interest will be paid in full.

The second safest class of bonds and bond funds is the municipal market. These bonds come in two forms. First, there are general obligation bonds, which are repaid with general tax revenue received by the municipality.

And then there are revenue bonds, which are paid back with revenue from a specific project -- a hospital or a convention center for example. Obviously general obligation bonds are safer than revenue bonds. To compensate for the risk, revenue bonds have higher yields.

Corporate bonds and bond funds offer higher yields than Treasuries and munis, but they also present greater risk. That's because corporations can go bankrupt more easily than the government.

If you're going the corporate route, Sheldon suggests a short-term investment-grade fund. Investment-grade bonds are ones credit rating agencies think have little chance of defaulting. "In that kind of fund, you're getting diversification; low interest rate risk, though you'll have some; and low credit risk," he says.

One approach Sheldon recommends is a laddered bond portfolio. You buy bonds or funds with a range of maturities, so that you have the benefit of short maturities -- safety -- and the benefit of long maturities -- yield.

Individual bonds vs. bond funds

If you're buying bonds as opposed to bond funds, you have an advantage in an environment of rising interest rates. That's because when your bonds mature in such an environment, you can reinvest the money into bonds with higher yields.

Most experts recommend that you stick to bond funds unless you have at least \$100,000 to invest in individual bonds. That's because individual bonds can be very expensive, their fees are often opaque and many don't have great liquidity, making them difficult to buy and sell.

Bond funds also offer broad diversification and professional management. "When something fails, you want to be in a position to absorb it," says Taylor Gang, vice president at Evensky & Katz Wealth Management. "In a large, diversified portfolio there will be less of an effect."

In any bond strategy you choose, remember that the longer the duration of the bond or the bond fund, the more risk you are taking. Like bond maturity, duration is expressed in years. It's designed to convey a fund's sensitivity to interest rate changes. If a fund's duration is five years, its share price will decline 5 percent if interest rates rise by a full percentage point.

"You have to understand the risk of duration exposure," Gang says. "People probably underestimate the degree of exposure to interest rate risk when they go out on the yield curve."

When the Federal Reserve next raises interest rates, long-term bond prices may fall 20 percent, says Legend Financial's Holtzman.

Stocks

If you can stomach a bit more risk, you might choose stocks or stock funds that focus on stable companies with high dividends.

"Between consumer staples, energy, utility and telecom companies, you can pick up attractive yields with low volatility," Sheldon says. "But keep in mind if you buy stocks that they aren't a perfect substitute for money markets because of the risk."

Risk could quickly derail the best-laid [retirement plan](#), as many retirees learned in the recent stock market rout.

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Dan Weil is a freelance writer in West Palm Beach, FL.

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