PBS IBonds With Spencer

Patty Brennan: Hi everybody. Welcome to the Patty Brennan Show. Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

As part of our podcast program, from time to time, we get questions, and today, one of the questions that we've been getting an awful lot is how do I create or hedge against inflation? Joining me today is Spencer Pete. Spencer's a member of our portfolio management team.

We're so grateful to have Spencer with us, not just today, but he's chosen Key Financial to be his home, and boy we are so grateful that he has. Spencer, welcome to the show.

Spencer Pete: Thank you, Patty. This is such an honor to finally get to do this with you, and we've been getting a lot of questions recently about Series I bonds. We see it on Good Morning Today, we see it on CNBC, Bloomberg. Really on a lot of outlets getting questions about them. This seems like a good opportunity to discuss them with you.

Patty: Perfect. Let's get right into it. I bonds. Where do you get I bonds? How do they work? They're a hedge against inflation, but there's actually two components to them, right?

Spencer: Yes. Where you would go to actually purchase I bonds is treasurydirect.gov. From there you can either do an electronic I bond, which would allow you to buy $10,000 per person per year. Say you're married, you'd be able to do $20,000 per year.

Now for a paper bond, which is a paper I bond, you would be doing that through your tax refund and your limit on that is $5,000. Then the components of it are a fixed rate and then an inflation that's adjusted twice a year in May, and then in November.

Then, so recently the fixed rate is about zero percent. We haven't seen in the last three years that raised at all. Then that second rate is that semi-annually adjusted rate, which is based off the consumer price index.

Patty: That's interesting. No ifs, ands, or buts you're going to get a zero percent, at least maybe in 30 years you'll get your money back, but you just don't really know what your rate of return is actually going to be until inflation is published twice a year, right?

Spencer: Yes, that's correct. That principle would be guaranteed depending on what you purchase in that year. Above that, that fixed rate, that's going to be zero. That secondary rate, that's what's going to change moving forward.

Patty: Let's look back historically on that fixed rate portion. It hasn't always been zero percent, right? It used to be, what, three percent?

Spencer: Yeah, so in the last 10 years, it's basically hovered around that zero percent. If we look back 20 years, early 2000s, that's where you start to see the fixed rate was between two to three percent. Recently, no, we have not seen that coming for that while.

Patty: For people who bought it way back then inflation really wasn't an issue. They might have gotten that two percent and maybe another one for inflation or two for inflation. Again, not a bad deal, but it just wasn't the rate of return that many people got on other instruments, right?

Spencer: Yes. Correct.

Patty: Fast forward to 2022 and it's a whole different ballgame, right?

Spencer: Yes.

Patty: These are paying over 9 percent right now, right?

Spencer: Yeah. Right now it's actually 9.62 percent, so that semi-annual adjusted raise, 4.81, multiplied that by two, and that's how we arrive at that 9.62.

Patty: Not a bad deal. It sounds really high, but let's face it guys, that's what inflation is, right? It's a hedge against inflation and a good place for what part of the investment portfolio, Spencer? Or what? How do they work?

Spencer: From our perspective, we use the three pools of money. That first pool being the one to two years of cash flow needs, that second pool being from two to five, and then past five is where you're looking for the long term investments.

Now a Series I bond, in that zero to one year, you're not even allowed to redeem it.

Patty: Oh, so you can't, even if you wanted to. No ifs, ands, or buts.

Spencer: Nope. In the first 12 months you were not allowed to redeem it. Then from that one to five, you actually will be penalized for three months of interest when you redeem that bond.

Patty: The three months of interest is basically taking away some of that CPI, assuming that there is CPI?

Spencer: Mm-hmm. For example, that four 4.81 that I mentioned that would be hacked.

Patty: Then the question is, so there's different types of government bonds. We've got these I bonds, you've got the limit of 10,000 per person in a household. What about TIPS, Treasury Inflation Protected Securities? That's also a treasury bond. How do they work? How do they differ?

Spencer: One of the main differences between a TIP and then an I bond is a TIP you can buy on the secondary market, and with I bonds, they guarantee that principle amount on your initial purchase. Now, the TIPS, because it's on the secondary market, it's subject to the supply and demand and whether people actually want and how they value that bond.

Patty: You're going to see some fluctuation in the value of the bond?

Spencer: Mm-hmm.

Patty: Pros and cons. It might be a little bit more liquid, but you're going to have to deal with fluctuations in exchange for that liquidity. In terms of portfolios, like when people are calling, what are we telling them in terms of is that an important part of their portfolio? How are we using I bonds for client assets.

Spencer: When we are talking to clients about I bonds, first we always want to mention, unfortunately, we can't purchase it for you. That's where you go to the treasurydirect.gov, then you can apply online or the tax refund like I mentioned earlier.

We always just going through and educating people about I bonds. I think that you see it so much in the news that people want to know, but they don't always have the background in it. Just try to educate them. If it's in that zero- to one-year timeframe, this isn't going to be good for you.

Maybe if you have, an emergency fund that you're looking for in the next one to five years, this could be a good spot for an I bond, but then, if you look at out five years, we would prefer being in equities.

Yes, there's some downside in volatility with equities, but on the long term an equity is most likely going to outpace an I bond.

Patty: We mentioned equities. What about bonds in general, especially given how much they've lost this year? What's interesting about this whole conversation is that if you look at I bonds and the rate of return that they are achieving this year and compare it to a 20 year treasury, 20 year treasury bonds are down 31 percent.

That's huge fluctuation in one year that you wouldn't have with these types of bonds. Now, that's bad news, but maybe it's also good news, right? Because they are down so much, what is the likelihood that treasury bonds are going to be down further five years from now?

That begs the question, is an I bond a good long term investment? Or is it more of an emergency fund alternative?

Spencer: Yeah, no. I definitely say it would be an emergency fund. With the Feds policy recently, with the tightening, I don't see it going much further. They said they're going to continue to do it, but you've already seen even with the UN member that came out and said that they wanted to kind of decrease rates already in this past week.

I don't see the public getting on board to fight this inflation for another two years if it were to happen. Hopefully, in the short term, rates would be alleviated.

Patty: The thing about inflation that we also have to keep in mind is it is a comparison year-over-year, so it's already high. What is the likelihood that 12 months from now it's going to jump another 9 percent from where it is?

I'm not so sure. I doubt it. Seriously, especially given what the Fed has come out and said, they are not falling around, they're going to increase interest rates and they're going to keep them there until they're certain that that inflation is getting backed down to that two percent target range.

Again, just to summarize, I bonds, TIPS, inflation protected securities of any kind, not bad security as an emergency fund. I like it as an alternative to money market accounts because it's going to take a while. Money market account interest has come up but it's not at nine percent yet.

Eventually it might catch up. In the meantime, a portion of your emergency fund certainly can be invested in these inflation protected securities, whether it be the I bonds or TIPS. With that in mind, anything else that we should add?

Spencer: No, I thought that we really covered there.

Patty: All right, so let me stop there.

Spencer: I don't know if I explained that, like future outlook. I just seen like push back with Drome Powell saying he's going to continue to...

Patty: I think that it's fine, because then what I said was he's going to stay high and he is not fooling around. Hopefully that'll give that alternative. Should I say something about EE bonds being double? No...

[crosstalk]

Patty: Yeah. Another can of worms. What was the last part? What was I saying to summarize? Ready? So Spencer, what do you say to summarize all of this, I bonds a good alternative for your emergency fund as long as you're not going to need them for the next year, because you cannot redeem them in the first year and you're going to lose three months of interest for the first five years.

Hopefully you're not going to need your emergency funds. They're legit for just emergencies. If you have an emergency, OK, so you're going to pay a penalty, but it's better than having to sell something when the market is down 25 percent.

It's a reasonable alternative. Now you have cash equivalents, like money market accounts and that sort, but money market accounts really are not even close to keeping pace with inflation yet. Eventually the interest will come up, but that hasn't happened yet.

I like this and I think that you do as well as an alternative for a portion of the emergency fund. Again, I really like the liquidity aspect of just having money in the bank. Spencer Pete, thank you so much for joining me today. I really appreciate the information.

You've been taking a lot of these calls and, you've been very educational and very...Time out. You've been taking a lot of these calls and you've been great with clients in terms of explaining what would normally be a pretty complicated topic with lots of ifs, ands, or buts in a way that they can digest it.

You've given them great direction to treasurydirect.com, .gov. I always get that mixed up. Again, it's another tool. These tools are important. We're here to provide lots of choices and...Oh, forget it. I'm really messing up.

Tech: Take your time. Don't be in a rush.

Patty: You've done a great job of educating our clients and I personally really appreciate it. As do they by the way. I get lots of kudos about Spencer Pete, so thank you for that. Thanks to you for joining me today. I hope this has been helpful. Again, it's another, arrow in the quiver in your fight against inflation.

It may be for you, it may not, but we just wanted to break it down in a way that you can understand it, and hopefully this has been helpful. I really appreciate you tuning in. In the meantime, I am Patty Brennan. Thank you so much for joining us today. We're Key Financial Wealth Management With Wisdom and Care.