

Financially Speaking

With Trisha Arndt, CFP®

Interest Rates are low so... Interest Rates are low

After a two year period when I thought I had seen just about everything that could happen in the financial marketplace I experienced a new first recently.

I was contacted by a client with a question about his money market mutual fund*. It is managed by a very large, well-known mutual fund company and is in fact the same one that I use personally. He wondered why he hadn't received a confirmation of the dividend that he normally gets each month. I think he expected me to answer with something like, "they are no longer sending paper confirmations" or "the dividend payment schedule changed" or something along those lines.

In fact, the answer was quite simple – there was no dividend.

You see, one of the affects of all of the actions taken over the last couple of years to prop up the financial system and get credit flowing again is an extremely low interest rate environment. In many ways low interest rates can be a good thing – it allows individuals and businesses to borrow money at potentially very attractive rates, such as the historically low mortgage rates we have been enjoying. This low cost of borrowing can spur economic activity by encouraging consumers of all types to spend money now while borrowing costs are attractive. This increased activity is a large part of the improved picture that we are finally starting to see in the economy.

But if borrowers are able to take out loans (or issue bonds as the case may be) at low rates that means that the issuers or purchasers of the debt are earning lower interest rates on their capital as well. As these lower rates percolate through the system they can eventually lead to some historically low yields for even the most conservative investors.

Case in point being the money market mutual fund that I own. For that particular institution the interest rates that they are able to earn are currently so low that they are not even covering operating costs. The financial institution is supplementing the money market mutual fund from its own coffers to avoid investors seeing a decline in the value of their principal.

Similar stories are being told all around the financial industry. For those institutions that are still able to pay investors on their cash accounts the rates are certainly far from what investors have come to expect. The FDIC insured bank sweep account that is used in my brokerage account as the default cash position is currently paying .05% annually. That means for every \$1000 I have in the cash position I am earning a whopping \$.50 a year. Yes, you read that right, 50 cents a year.

A quick check of a couple of local banks told a similar story. Regular savings accounts at one bank I called are currently paying .10% (or \$1 a year on a \$1000 deposit). This isn't because the bank is being greedy or wants to take advantage of its customers – it truly is a function of the world we live in today.

In some cases you can receive a higher interest rate through a bank or other financial institution if you either qualify for a special program (such as a minimum deposit or multi-account incentive) or if you are able to commit to a set time frame such as with a Certificate of Deposit (CD). Be sure to carefully think through any obligations of such programs to make sure that they fit your situation but certainly explore them if you feel they may make sense for you.

If you are sitting with a large stock pile of cash simply because you were afraid to do anything else with it now may be a good time to start talking with someone you trust about other alternatives for the money.

Ultimately, however, almost everyone should have some amount of freely accessible cash available to fund larger periodic expenses (such as property taxes or, in my case, the looming LP heating bill) and/or as a cushion in case of the unexpected. So while interest rates are historically very low right now that doesn't mean that the reasons for having these accounts have changed.

Interest rates change over time and eventually they could begin rising again. In the meantime I'm going to take my 50 cents and be happy with it.

Have a financial question or a topic that you'd like to see a column on? Email me at Trisha@wealthstrategies.biz.

**Money market mutual funds are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity so they may lose value.*

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