VANTAGE POINTE
Vantage Financial Partners Limited

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RISING INTEREST RATES & FIXED INCOME

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Interest rates have steadily declined over recent years, but eventually they are expected to climb. How would your portfolio react should interest rates begin to rise?

Typically a portfolio consists of several different types of securities such as equities, alternatives and fixed income positions. The fixed income allocation historically fluctuates less dramatically than the others, and is usually incorporated to provide income and stabilize the portfolio. However, fixed income securities are not without their own risks, and interest rate risk generally has the greatest impact on performance and valuation of this portion of the portfolio. Interest rate risk is prevalent in today's market, but through proactive management the effects can be minimized.

THE CURRENT ECONOMY

In our current interest rate market, the Federal Reserve has set target rates at 0-0.25%. This rate has been brought down from 5.25% in September of 2007 to stimulate growth and investment in the equity market. However, due to the uncertainty of our present economy, a record number of investors have shown a preference toward the fixed income market in an attempt to preserve their capital. Both the reduction of interest rates and the increased demand have had a dramatic effect on the price of these securities. But what will happen when the Federal Reserve begins to increase rates? Before that question can be answered, let's review how fixed income investments work.

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FUNDAMENTAL OF FIXED INCOME

Fixed income securities are issued at face value or par. Once exposed to the market, their value either increases or decreases, depending on several factors. For example, assume a bond is purchased at a price of $1,000 with an interest rate of 5%. At the end of 12 years, the bond will reach maturity and the original par, or face value, is repaid. During the term of ownership coupon (interest) payments, are made to the owner bi-annually.

The value of a bond can change should interest rates rise or fall. If the Federal Reserve reduces interest rates to 4%, new bonds will be issued at this rate making the bond in our example above, more attractive due to the larger coupon payment. If this same bond were to be sold, theoretically it would receive a value of more than $1,000. The opposite would become true should the interest rate rise to 6%. Of course the date of maturity can also factor into a bond's current value. So how do we understand the value of a bond at any given time? This is accomplished by calculating the bond duration.

Duration is the measure of time, typically in years, that it will take an investor to receive back his or her original investment. Several factors are included in this calculation, including coupon payments and call risk. The measure of bond duration is critical in understanding the value of a bond at any time in relation to its maturity, and can therefore be used to determine the bond's value as well as its sensitivity to interest rate risk.

FIXED INCOME ALLOCATION

In the selection of bonds within a portfolio, it is crucial to consider the duration, the date of maturity and the interest rate of those bonds. As interest rates begin to rise, the fixed income allocations within some portfolios may see a reduction in value. Investment managers at Vantage are currently managing interest rate risk within client portfolios by shortening the duration of bond holdings while looking for higher coupon payments. These steps help to limit the volatility of interest rate increases on fixed income securities. They also can help insulate against price fluctuations resulting from increasing interest rates.

Many other factors, such as tax consequences and income requirements, should also be considered when making changes within your portfolio. Please contact your Relationship Manager to review your portfolio needs.

VANTAGE NEWS

Getting better acquainted with one of our team members...

FAVORITE MOVIE	The Dark Knight
FAMILY	We still return to the same vacation spot that my grandparents visited when they were growing up; Eagle River, WI.
PAST	I started saving at a young age. When I got my license, I was able to buy my first car, a '95 Ford Mustang, with my savings.
SURPRISE US	I have served as a DJ at high school dances for five years.
OUTSIDE OF WORK	I enjoy networking and meeting new people.
AT VANTAGE	I love meeting and connecting with clients when they come to the office.
ANYTHING ELSE	I have wanted to be in this industry since my early high school years. Working at Vantage has allowed me to fulfill my passion and stay close to home.

Jay Kulikowski
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