



## Inflation-protected bond rates are plunging. Why is that good news?



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Investors who piled into I bonds while they were paying an interest rate of nearly 10% in the summer of 2022 are seeing a payout of less than 4% now that record high inflation has cooled off.

I bond interest rates soared to 9.62% amid the highest inflation in four decades because the payout is tied to the rate of U.S. inflation and adjusted every six months based on the rise and fall of consumer prices. But while I bond returns are likely to lower as inflation continues to fall, many investors are still comfortable owning the government-guaranteed bonds — even if they're not as lucrative as they were a short time ago.

“None of my clients that invested in them are looking to sell,” said J. Victor Conrad, owner of Pinnacle Financial Strategies in Pine.

Mr. Conrad noted that he and his wife personally bought \$10,000 worth of I bonds when the rates were nearing 10%. And while they're receiving



3.94% on the I bonds today — “we’re not looking to sell them now.”

I bonds remain a safe asset for people who already own them, according to Michael Godwin, at Sewickley-based Fragasso Financial Advisors. But new purchases have slowed considerably

“We’ve had no client interest or inquiries on I bonds,” said Mr. Godwin, the firm’s chief investment officer. “I bonds made sense back in 2022 when they were paying more than 9% on a six-month basis. But given that inflation rate expectations are coming down, we’re having no demand from clients at this point.”

Treasury bonds such as I bonds represent loans that investors make to the federal government. When investors buy bonds they essentially loan the government the amount of the bond for a specified period of time — the maturity date. In return, the government promises to make regular interest payments to the bondholder and return the original investment amount when the bond matures.

Bonds — like bank CDs — can be redeemed before their maturity date, but it usually results in a loss of interest payments or possible loss of some principal.

For the most part, bonds are considered to be safer investments than stocks. While stocks rise and fall in value, bonds provide a steady predictable stream of income and a guaranteed return of all of the principal if held to maturity.

New I bonds issued between Nov. 1, 2023 and April 30, 2024 have a yield of 5.27%, which is paid every six months.

“Right now, I bonds are still attractive because the 5.27% rate is higher than many of the comparable short-term treasuries,” said Matthew Yanni, owner of Yanni & Associates Investment Advisors in Pine.

The U.S. 10-year treasury bond is currently yielding 4.12%. According to Bankrate.com, the national average yield for a 5-year bank CD is 1.45%. Several online banks pay more than 5% for 1-year CDs.

“I wouldn’t be selling I bonds to buy CDs,” Mr. Yanni said. “Even for new investors, I would probably lean towards the I bond in most cases.”

## **A safe, inflation-proof investment**

I bonds are a slightly differently animal than most other U.S. treasury bonds.

Wealth managers are actually restricted from buying I bonds on their clients' behalf, which isn't the case with most other bonds. With I bonds, advisers can only guide clients through the process of buying directly from the government through [treasurydirect.gov](https://www.treasurydirect.gov).

There's also a \$10,000 annual purchase limit on I bonds, whereas there's no purchase limit on other long and short-term treasury bonds.

I bonds can only be redeemed through [treasurydirect.gov](https://www.treasurydirect.gov). Bond holders have to wait at least 12 months to sell an I bond, and if they choose to sell within five years, they lose the last three months of interest.

The interest income from I bonds is unpredictable because the rate changes every six months.

Still, for many investors, I bond investments are worth the hassle.

They are risk-free investments backed by the federal government, which are adjusted every six months to guarantee a return that will at least outpace the rate of inflation over 30 years.

What's more, while the interest on I bonds is federally taxable, the investments are exempt from state and local taxes.

Also, if I bonds are used for qualified higher education expenses, all the interest may be tax exempt for lower and middle income households.

## **'A pretty good credit risk'**

Mr. Godwin, of Fragasso Financial Advisors, believes that investors with new money can find better options than I bonds, especially since he expects inflation to be held in check going forward.

The Federal Reserve has declared a war on inflation. If the Fed is successful, inflation will continue to go down — as it has, steadily, since reaching a decades-old high of around 9% in June 2022 to 3.4% today.



So, for I bond yields to rise, the Fed would need to fail.

“We certainly think there can be a slight reaccelerating in inflation particularly if the Fed cuts interest rates too much this year, but we will likely not come close to testing the inflation we saw in 2021 and 2022,” Mr. Godwin said. “Thus, we think there are better alternatives within the fixed income market at generating higher returns than an I bond.”

Now that the interest rate has fallen to 3.94%, Mr. Conrad argued that the penalty of losing three months in interest for selling I bonds before the five-year cutoff is not a major deterrent.

But there’s no reason to sell I bonds unless an investor needs the money or has a better place to invest it, he said.

“What are you going to do with that money compared to getting 3.94% guaranteed by the federal government, which is a pretty good credit risk?” Mr. Conrad said.

I bond owners can avoid the 3.07% Pennsylvania income tax. Mr. Conrad added that he has seen folks take advantage of I bonds for covering higher education costs.

“If you use that money for qualified education expenses, you don’t pay tax on the income,” he said. “So, there’s a silver lining around the cloud there.”

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