Investing

High-Yield Bonds and Savings Ideas as The Fed Weighs a Rate Cut

Check out some of these investing ideas ahead of potential interest rate changes.

(Image credit: Getty Images)

In my past few columns, I lauded bond ladders and high-yielding funds that own receivables such as bank loans and credit card obligations. With the Federal Reserve getting closer to easing credit as economic indicators cool down enough to disturb the stock market, it is ever wiser to guarantee potent income. Those effortless 5% cash returns will not vanish overnight. But by Thanksgiving, 4% is a realistic expectation for money market funds and Treasury bills.

For many of us, 4% is perfectly fine — especially if your personal inflation experience is diminished. That often varies with whether you rent or own and what you pay for car and property insurance.

But if 4% is inadequate, or you remain inclined to take risks, the combo of falling yields and retreating expectations for inflation in the bond market stands to reward higher-coupon and higher-dividend holdings. (Those market expectations for inflation run lower than what consumers refer to as the cost of living and so can accelerate a decline in interest rates.)

Consider the week of July 29, when the Fed's brass said it is about time to cut rates, and bad tech-company results then bludgeoned 1,500 points off the Dow Jones industrial average and 1,000 from the frothy Nasdaq composite.

But beneath the red on those indexes, the markets emphatically and unambiguously supported low-risk, high-dividend names such as AT&T, Realty Income, Verizon, and the regulated electric and water utilities. (High-growth, lower-dividend utilities and real estate investment trusts did take their lumps, though.)

Bonds' big move: The bond market, meanwhile, rallied sharply. Among the gainers were our most esteemed actively managed bond funds, including Dodge & Cox Income (DODIX) and Fidelity Strategic Income (FADMX), which saw healthy upticks in net asset value atop their ongoing 4.7% and 5.3% distributions.

Readers can stand by these multisector bond funds, as well as high-yield and short-duration funds I've previously recommended, such as exchange-traded funds BlackRock Flexible Income (BINC) and PGIM Short Duration High Yield (PSH) and mutual fund RiverPark Short Term High Yield (RPHYX).

The Fed does not control the market rates that feed into their payouts the way it does with bank deposits and money funds, so the distributions, which currently run 5.7%, 9.1% and 5.4%, respectively, will not shrink much, if at all, in the near term. And easier credit terms stand to bolster the business prospects for the industrial and financial firms whose debts these funds hold.

Another extra-yield idea: The Federal Farm Credit Banks and the Federal Home Loan Banks are offering new bonds due in seven to 12 years with coupons of 5.7% to 6.0%. These government agency bonds are callable at par value six months after the date of issue, but that still means a premium yield for at least that long, as well as a chance to sell the bonds for a profit before the initial call date if these lenders' rates on their next rounds of financing are 0.5 or 1 percentage point lower.

And as for cash: As I write this, you could still originate a two-year CD ladder with an average percentage yield of 4.7%, or a one-year version for 4.8%. These yields stand to be lower in a few weeks and certainly once the Fed's first cut is official.

And if the next few monthly or quarterly jobs, retail sales, housing starts and other broad economic indicators soften, the central bank is unlikely to reduce short-term rates by more than 0.5 percentage point right away. The days of zero interest rates and "cash is trash" are not going to return, but neither will the appetite for higher yields be going away.

NYSUT NOTE: Looking to earn more on your savings? Check out the NYSUT Member Benefits Corporation-endorsed Synchrony Bank Savings Program, which offers some of the most competitive interest rates on certificates of deposit, money market, and savings accounts.

About the Author

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