How a 1% Gain Can Destroy Your Retirement Dreams

Sep 10, 2013 – 01:47 PM GMT

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Robert Hsu writes: This has been the bond market's worst showing in 19 years, thanks to the recent spike in the 10-year Treasury yield. But bond investors aren't the only ones getting hit.

A higher "risk-free" rate affects you, too. And me. And anyone else trying to grow their money.

It's time to make an adjustment.

A big one.

So let's look at three new "dead money" investments, and one that's "living large" – a company that can give you what few others still provide: a steady double-digit annual return, year after year.

But we'll start with the shift itself, because this seemingly benign 1% move has triggered what could be the single greatest risk to your retirement dreams…

Like 1994, But (Much) More Devastating

The yield on the 10-year Treasury note is just under 3%, and though that doesn't seem like a very destructive number, it is the highest rate on this benchmark interest rate metric since July 2011. More important, however, is the tremendous rate of change in the 10-year yield over the past four months, and it demonstrates how a 1% "spike" in interest rates can have a devastating effect on your retirement plans.

On May 10, the yield on the 10-year was 1.90%. Nearly four months later that same yield was 2.90%. This 1% headline move in the yield actually represents a 52.5% spike in the metric, an extreme rate of change that has sent bond prices tumbling, and with it the value of millions of retirement accounts holding Treasury bonds.

Indeed, the move higher in the 10-year yield has wreaked havoc on traditional income investments, because as bond yields rise, bond prices fall. This inverse relationship between yields and bond prices is the main reason why the bond market is having its worst year since the notoriously destructive 1994.

This time around, the spike higher in bond yields and concomitant drop in bond values could have an even more detrimental overall effect, and that's because there are many more investors that are either in retirement or nearing retirement, which means there are more traditional fixed-income investors today than there were 20 years ago.

Unfortunately, the Wall Street marketing machine has sold retirees on the idea that Treasury bonds are "low-risk" assets, but as we've seen this year, these bonds offer little or even negative returns in exchange for this so-called "low risk."

For example, one of the most widely held bond funds right now is the iShares Barclays 20+ Year Treasury Bond (TLT), which yields approximately 2.90%. In exchange for that yield, you've been dealt about a 15% loss in the price of that fund since May. Another widely held bond fund is the iShares iBoxx $ Investment Grade Corp. Bond (LQD). This fund offers investors a yield of 3.9%, but since May the share price has plummeted more than 8.5%.

As you can see, these so-called "low-risk" bond funds are anything but low risk.

Unfortunately, the idea promulgated by the big brokerage houses and sold to unsuspecting income seekers has caused many trusting investors to pile into the same "safe" investments. And as we've seen this year, when a trend reverses and catches so many investors off guard, the risk of a big panic selloff is exacerbated.

Think of this phenomenon as akin to shouting "Fire!" in a crowded theater. When the stampede for the exits ensues, people tend to get hurt badly.

So, what can you do to make sure you don't get trapped in a wealth-destroying mass exodus?

Invest in the "New Income"

The latest "1% move" in the 10-year yield is, in my opinion, the first of many such moves. In fact, we could see the yield on the 10-year rise to 5% or even 6% over the next several years, back to the level where this metric was before the global financial crisis hit.

If I am right about this, it means that the value of traditional income investments will continue to decline for years to come. It also means that if you want to capture the income you need to fuel your retirement, you have to start looking at your money with a growth-oriented eye. (You'll see what I mean.)

You'll also benefit from more sophisticated income-generating strategies involving options and unconventional income-producing assets, such as energy transport partnerships and other growth-oriented assets – if, that is, you want to keep your money from getting destroyed by rising interest rates.

Source :http://moneymorning.com/2013/09/10/how-a-1-gain-can-destroy-your-retirement-dreams-part-one/