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## Ask the Experts: Financial FAQs (Fall 2018)

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### **Q: With the Federal Reserve raising interest rates and mortgage rates rising, should I avoid bonds?**

**A:** No. Bonds can still deliver positive returns in a rising-interest-rate environment and remain a key piece of a diversified portfolio.

Many investors are understandably concerned that rising interest rates will negatively impact their bond portfolios. While increasing interest rates may lead to price volatility, rising rates do not necessarily create bond losses. Barring a default or an early call, bonds held to maturity will generate positive returns regardless of interest rate movements. In addition, rising rates provide bond investors an opportunity to reinvest their coupons or the proceeds of maturing bonds at higher interest rates.

Consider a hypothetical scenario. An investor purchases a 5-year bond that pays \$5 per year in interest for \$105. We don't know how interest rates will behave in the future or how the bond's price will fluctuate due to changing interest rates. But we do know the bond will pay the same interest amount every year—again, assuming the issuer doesn't default or call the bond early. We also know the bond will mature at par (\$100), so we know the bond's price will decline by a total of \$5. Thus, the bond earns the same total interest (\$25) and depreciates the same amount (\$5), regardless of interest rate movements along the way.

History also provides a guide. In 1940, interest rates began an upward trajectory that lasted into the early 1980s. The 10-year U.S. Treasury yielded a mere 2 percent at the start of that climb and ended near a towering 14

percent in 1981. Yet, over that 42-year period, the 10-year Treasury's annualized return was positive, and there were only a handful of years when bonds had a negative total return. In the worst year, the drop was only about 5 percent.

While we do not anticipate trouble ahead for bonds and believe they should be part of a well-diversified portfolio, we know that investment risk tolerance is highly personal and that every investor's circumstances are unique. So please talk to your financial advisor about your unique needs and considerations before making any decisions or changes to your portfolio.

**Q: My daughter has been saving for a down payment on her first house, but the hot real estate market has made it hard for her to afford the kind of home she wants. What's the best way to help her out?**

**A:** Your daughter is not alone. With rising home prices in many metropolitan areas, homebuyers—especially first-time home buyers—face several headwinds, including the challenge of coming up with a down payment, lack of credit experience, and higher debt-to-income ratios. These three intertwined issues mean that many young people are finding it challenging to get a home mortgage. The good news is that the right kind of financial help from family can help make homeownership a reality.

For parents who can afford it, there are numerous ways to help a child become a homeowner:

- **Give the gift of a down payment**—A cash gift from a parent used to fund a down payment will make it easier to qualify for a mortgage because it lowers the mortgage loan amount, improves the child's debt-to-income ratio, and reduces the mortgage payment amount. This is the most common way parents help children buy homes.
- **Consolidate your child's loans**—If your daughter has student, auto, or other loans that affect her credit or ability to borrow, consolidating her loans may be a solution. By paying off her debt, you free up her credit and create debt space to allow her to qualify for a mortgage (or perhaps a larger mortgage).
- **Co-sign a mortgage**—Co-signing a mortgage with your daughter would likely improve her ability to borrow (or borrow more). You should only consider this option if you have the confidence that she is going to be able to afford the monthly mortgage, tax, and homeowners' insurance payments. If she defaults on the loan, as co-borrower, you will be responsible for it.

One last option—although it doesn't accomplish the mission of helping a child buy a home—is to buy the home yourself and rent it to her. If you go this route, make sure to document the rental agreement and payments she is making to help ensure that she has a good payment history when it comes time for her to apply for a mortgage. This can be a complicated issue, so please make sure to consult your legal, tax, and financial advisors for their thoughts about your specific situation.

Have questions? Need help? Call the CAPTRUST Advice Desk at 800.967.9948 or [schedule an appointment](#) with a retirement counselor today.