

# Fixed Income Ladders

## TAKE THE GUESSWORK OUT OF INTEREST RATES

Investing in the fixed income market brings with it many different considerations; among them credit rating, maturity, and an ever-changing interest rate environment. Predicting interest rates is very difficult to do. By utilizing a portfolio strategy known as laddering, investors can take the guesswork out of fixed income investing by positioning their portfolios to take advantage of rising interest rates and simultaneously ease the effect of declining interest rates.

## WHAT IS A FIXED INCOME LADDER?

A fixed income ladder is a portfolio of fixed income securities structured with a series of staggered maturities. The objective of a laddering strategy is to create a systematic schedule where a portion of the portfolio is maturing and available for reinvestment at regular intervals. With maturing amounts coming due at scheduled times, an investor can take advantage of any increase in interest rates by reinvesting these amounts at the higher rate. Should interest rates fall; the investor can mitigate the drop in their returns by having the remaining amounts still invested at higher rates.

Illustrated on the next page is a hypothetical five-year ladder consisting of fixed income securities. A ladder can consist of any combination of corporate bonds, U.S. Agency and/or Treasury securities, municipal bonds, or Certificates of Deposits. The key component when building an investment ladder is to have securities mature in one-year increments. This schedule of maturities allows the investor to ladder across the investment horizon (*the Initial Ladder*).

To maintain the ladder on an ongoing basis, the investor purchases a new five-year fixed income

security to replace the maturing bond, thus keeping the maturities staggered in the portfolio. As demonstrated in the sample ladder, when continuing to reinvest in this vehicle, investors obtain numerous benefits: interest rate diversification (no concentration in a single maturity), a short average maturity, and a higher blended return (*the Reinvestment Ladder*).

## LADDERS TAKE THE GUESSWORK OUT OF INTEREST RATE SWINGS

A ladder is comprised of securities maturing at regular intervals. When a bond matures, if interest rates have risen, the new security added to the portfolio brings with it a higher yield, thereby increasing the overall yield of the portfolio. If reinvestment rates have fallen, the remaining fixed income securities in the portfolio may earn a higher yield than is currently available in the market. The net result of a ladder strategy is interest rate diversification and a less volatile blended portfolio.

## LADDERS PROVIDE INTEREST REWARDS

Fixed income ladders provide predictable interest income and can be structured to provide monthly or quarterly payments. Rather than spend these payments, investors may choose to reinvest the interest payments from the portfolio in the purchase of the replacement bond, thus compounding their investment returns.

Fixed income ladders are a prudent diversification strategy for all fixed income investors.

By taking the guesswork out of interest rate movements, ladders afford protection from interest rate fluctuations, lessening the risks of fixed income investing.



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## Fixed Income Ladders, continued

To find out more about fixed income strategies and bond ladders, please contact your RBC Wealth Management® Financial Advisor.

|                                 |              | Year 1 | Future Portfolios |               |               |               |
|---------------------------------|--------------|--------|-------------------|---------------|---------------|---------------|
| Initial Ladder                  | 1yr Security | 3.45%  | <b>Year 2</b>     |               |               |               |
|                                 | 2yr Security | 3.50%  | 3.50%             | <b>Year 3</b> |               |               |
|                                 | 3yr Security | 3.55%  | 3.55%             | 3.55%         | <b>Year 4</b> |               |
|                                 | 4yr Security | 3.60%  | 3.60%             | 3.60%         | 3.60%         | <b>Year 5</b> |
|                                 | 5yr Security | 3.65%  | 3.65%             | 3.65%         | 3.65%         | 3.65%         |
| Hypothetical Reinvestment Rates | 5yr Security |        | 3.65%             | 3.65%         | 3.65%         | 3.65%         |
|                                 | 5yr Security |        |                   | 3.75%         | 3.75%         | 3.75%         |
|                                 | 5yr Security |        |                   |               | 3.50%         | 3.50%         |
|                                 | 5yr Security |        |                   |               |               | 3.55%         |
| Blended Return                  |              | 3.55%  | 3.59%             | 3.64%         | 3.63%         | 3.62%         |

*Yields shown are for illustrative purposes only and do not reflect current or future market conditions*

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