

## What the Federal Reserve's Stimulus Means to Investors

By Andrew Menachem

Several weeks ago, the Federal Reserve announced its top priority would be to stimulate the economy, even if that led to an increase in inflation. That means the Fed may plan to keep short-term interest rates at record lows through mid 2015. It will likely buy mortgage bonds seeking to make home buying more affordable, and consider other steps if the economy remains sluggish.

Around the world, the European Central Bank (ECB), the People's Bank of China and other central banks have also adopted "quantitative easing" monetary policies designed to make spur lending and boost national economies.

So, what does this long-term low-rate financial environment mean for investors?

First of all, it makes traditional "safer" investments like, cash alternatives (e.g., T-bills, CDs) less attractive. For example, a cash alternative, maturing in 1 year and purchased for \$100,000 offering a 0.50% percent-rate would only give you a \$500 return. These types of fixed-rate securities and deposits can still play a role in helping to build a diversified portfolio, but they won't grow significantly in value or help protect you against the risk of inflation.

In a low-rate interest environment, it doesn't make much sense to buy Inflation-protected securities (i.e., whose stated coupon fluctuates upon prevailing interest rates). Why pay a premium for that inflation protection, when the Fed doesn't believe it could be a problem for the next two years?

This fall, the U.S. stock market could very possibly be in a holding pattern, waiting for the November election results and watching the slow-moving European debt situation for signs of improvement. In this uncertain political and economic climate, you may want to consider fixed-rate assets such as investment grade corporate bonds, emerging market bonds and high-yield bonds.

Investment grade corporate bonds can offer higher yields than Treasuries or CDs, with only moderately higher investment risk since the issuing companies may have high credit ratings.

If you're willing to accept more risk, you might also consider looking at high-yield bonds or emerging market bonds. Many companies in emerging markets like India, Brazil and Russia may have stronger credit ratings than in the past. In fact, more than 60 percent of the companies listed on the Citi Emerging Sovereign Bond Index now have an investment grade rating, compared with about 30 percent a decade ago. That index measures the total return performance of international government bonds issued by sovereign emerging market countries.

Speaking of emerging markets, you could also consider adding equities, as well as bonds, to help diversify your portfolio. Holding emerging market equities can also create opportunities to benefit from differences in currency exchange rates. If you are buying securities denominated in Brazilian reals (BRL), for instance, the value of your assets may increase if the real (BRL) were to strengthen against the dollar.

Commercial real estate is another asset class that may provide attractive returns along with potential protection against the risk of inflation. In that regard, Real Estate Investment Trusts (REITs) that own a variety of office, industrial, retail or hospitality assets may appeal to investors who don't want to purchase and manage their own properties.

Since the global financial markets remain full of uncertainties, a prudent investor should continue to build a diversified portfolio with different types of assets. This is not the time to roll the dice and hope that the stock market will suddenly jump 800 points. Nor is it the time to put all your savings "under the mattress," so to speak. Instead, you should talk with your financial advisor and consider the opportunities, and the risks in today's financial markets.

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