Grins and scowls over interest rates

Hikes benefit some, hurt others: Do you know how to react?

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By PAMELA YIP / The Dallas Morning News

For Hall Martin, the long period of rock-bottom interest rates has really been a pain.

"I've got a couple of jumbo CDs that are giving us the grand total of 1.6 percent each," says Mr. Martin, a 70-year-old retiree. "There are a lot of us seniors who are hoping that rates do go back up."

If things go as expected, Mr. Martin will get his wish, because the lowest interest rates in recent history are in the process of becoming just that – history.

For the last couple of years, retirees on fixed incomes have been punished by stingy rates on their favorite income-producing investments, such as certificates of deposits and money market mutual funds. Borrowers, meanwhile, have been blessed with low-cost mortgages and car loans.

But that's in the process of changing, as the economic recovery continues. The nation's central bankers, led by Federal Reserve Chairman Alan Greenspan, are hinting that they'll have to raise the short-term interest rates they control in order to keep inflation from getting out of hand.

That should cause all interest rates to rise, altering the playing field for borrowers, savers and investors. The stock market, for example, is reacting negatively.

"Rising interest rates are not cause for panic," says Michael Busch, a certified financial planner and president of Vogel Financial Advisors LLC in Dallas. "Like most change, interest rate change is accompanied by both opportunities and risks. Prudent individuals will structure their financial affairs to both profit from the opportunities and to mitigate the risks."

With that in mind, financial experts offer the following advice for borrowers, savers and investors.

Consumer debt

If you're carrying credit card debt, act now to pay it off, or at least pay it down.

"Many credit cards are tied to current rates," said Bryan Clintsman, a certified financial planner at Clintsman Financial Planning in Southlake. "As interest rates rise, many credit card rates will float up, so carrying balances during this period of time is especially harmful."

As of Wednesday, the average interest rate on a standard variable-rate credit card was 13.51 percent, according to Bankrate.com. The average rate on a standard fixed-rate card was 12.85 percent.

If you're fortunate enough to hold a fixed-rate credit card, don't think for a minute that you're immune from rate increases.

"The issuers can change the terms with as little as 15 days' notice," Mr. McBride said. "In a rising rate environment, you can expect that those rates will move higher."

Car loans

It will become more important than ever to shop around for the best loan.

"The benefit of shopping around is that there is a huge disparity in rates that are available," Mr. McBride said. "Line up your financing prior to going to the dealership. That puts you in a stronger position if they're offering a cash rebate deal or low-rate financing. If you've lined up your own low-rate refinancing, you can take advantage of the rebate offer."

Last week, new car loans averaged 7.34 percent for a four-year loan, with an average rate of 8.36 percent for a three-year used car loan, according to Bankrate.com.

Mortgages

If you're thinking about buying a home, your choice of financing isn't as clear-cut as it once was.

"We're no longer at 41-year lows seen last June 2003, nor 37-year lows seen in March 2004," Keith Gumbinger, vice president at HSH Associates in Pompton Plains, N.J., which publishes mortgage information. On the other hand, "We don't have exorbitant interest rates at the moment."

Home buyers need to ask themselves a key question:

"Do I select a fixed-rate mortgage, which is less desirable than just a few months ago, and never worry about interest rates again, or do I select a product which is fixed but only for a while and need to have some concerns with what may happen to interest rates a few years down the road?" Mr. Gumbinger said.

The average rate on a 30-year fixed-rate mortgage was 6.3 percent for the week ending last Thursday, down from an average 6.34 percent the week before, according to Freddie Mac. The average rate on a one-year adjustable-rate mortgage was 3.99 percent, up from 3.90 percent.

A lot depends on how long you plan to stay in your home.

"If you're only going to be in the house five, six, seven years, an adjustable product might be more beneficial to you because the rate is a little bit less," said Craig Jarrell, president for the Dallas region of Pulaski Mortgage Co.

"The longer you live in a property, the more a fixed rate is attractive to you," Mr. Jarrell said. "The shorter you live in the property, the more attractive an adjustable rate is to you."

If you're thinking about refinancing, you're late to the party.

"If you've got an interest rate in the 7s, you could still refinance," Mr. Gumbinger said. "The sad tale is you still have missed your best opportunities to do so. The best opportunities to refinance were last year."

Savers

Yield-starved folks are about to get fed. Yields on money market funds have been under 1 percent, and it's not unusual for interest-bearing checking accounts to return a paltry quarter percent.

Although Mr. Martin, the Dallas retiree, isn't totally depending on interest income, the pea-sized returns have forced him to reconsider buying a car and going antique shopping.

"I have cut back on antiques," he said. "This whole thing trickles down. You have to zip up your wallet, and you don't spend as much."

Bond investors

Bonds are tricky, because although higher interest rates mean bonds will provide investors a bigger return, those who jump into bonds can lose money during a period of rising rates.

That's because investors will flock to the newer, higher-paying bonds and will offer less money for the lower-paying bonds you're holding, if you have to unload them before they come to term.

"The loss in value is most dramatic in long-term bonds," Mr. Busch said. "Investors should consider shortening the maturities of their bond holdings to reduce the risk of principal loss."

Most investors get into bonds through bond mutual funds. The trick while rates are rising is not to buy in all at once. It also helps to invest in funds that focus on different maturities.

Stock investors

Stock investors also need to be careful about how they invest in a rising interest-rate environment.

The industries that will be stung include financial stocks, utilities and consumer discretionary areas, such as retail and home building, experts say.

"Winners typically would be the defensive areas like energy, food, tobacco and health care," said Sam Stovall, chief investment strategist at Standard & Poor's. "In a rising interest rate environment, if you can eat it, smoke it and drink it, then you should buy it."