Navigate a changing interest rate environment

Q&A

- How can I successfully navigate a rising rate environment?
- How do interest rates affect bond prices?
- What is duration, and how does it relate to my fixed-income investments?
- So how much can interest rate changes really affect my investments?
- Beyond interest rates, are there other risk factors that affect fixed-income investments?

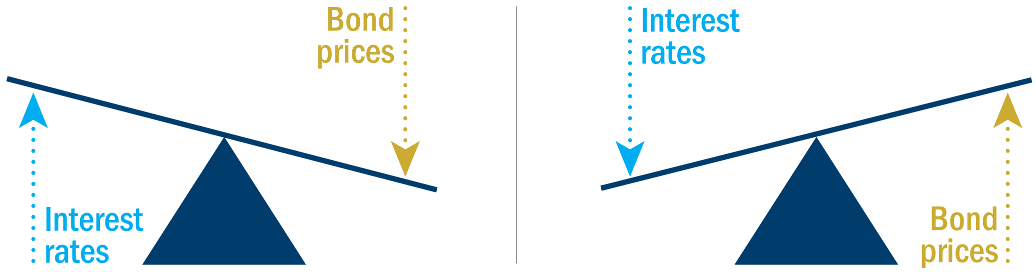
Q: How can I successfully navigate a rising rate environment?

Interest rates have the potential to wreak havoc on your financial plan. So when rates rise, it's natural to feel anxious — particularly about your fixed-income investments. But that doesn't have to mean avoiding interest-rate risk to mitigate losses. Rather than viewing rising interest rates as an obstacle to meeting your targeted investment income, consider rising rates an opportunity.

Some fixed-income products, particularly those with multi-sector investment strategies, are not only built to endure changing rates, they are built to thrive in all markets. Your financial advisor can help you select investments that are most suitable to your needs, to maintain your standard of living even when rates rise.

Q: How do interest rates affect bond prices?

Historically, interest rates and bond prices move in opposite directions. When there is a change in interest rates, there is an inverse change in bond prices. If rates are on the move, it may be time to reevaluate your fixed-income investments to ensure that they are managed to effectively navigate a changing rate environment.



As interest rates move up and down, bonds with longer maturities (higher yields) tend to have more price volatility, while bonds with shorter maturities (lower yields) tend to have less price volatility.

Q: What is duration, and how does it relate to my fixed-income investments?

Duration is the expected percentage price change of a security associated with a 1% change in interest rates. The longer the duration of a bond, the greater the bond's sensitivity to moves in interest rates.

The two main factors that affect a bond's duration are:

- **Time to maturity.** Bonds with longer maturities have greater sensitivity to interest rate changes. For example, a bond that matures in one year will repay its true cost more quickly than a bond that matures in 10 years. As a result, a bond that has a relatively shorter term to maturity has lower duration and less price risk.
- **Coupon rate.** A bond with a higher coupon rate tends to have a lower duration. If two otherwise identical bonds pay different coupons, the bond with the higher coupon will pay back its original cost more quickly than the lower yielding bond.

Q: So how much can interest rate changes really affect my investments?

The chart below illustrates a hypothetical example of how a 1% increase in interest rates can affect the value of your fixed-income investments. To minimize price fluctuation, investors will typically shorten their duration exposure to limit rate sensitivity. However, if your portfolio is generating the necessary levels of income and is in line with your risk tolerance, you may not need to make any changes. Work with your financial advisor to ensure your portfolio is optimized for your individual needs.

Interest rate change effect on fixed-income investments

Issuer	Yield (%)	Duration	Par value ($)	Estimated value after 1% interest rate increase ($)
30-year bond	3.25	19.1	1,000	831
10-year note	2.50	8.8	1,000	916
5-year note	1.50	4.8	1,000	953
2-year note	0.50	2.0	1,000	980

This hypothetical example is for illustrative purposes only and does not represent the performance of any specific investment. This example assumes all securities are sold at par with a coupon equal to their yield and an instantaneous parallel shift of interest-rate curve occurs.

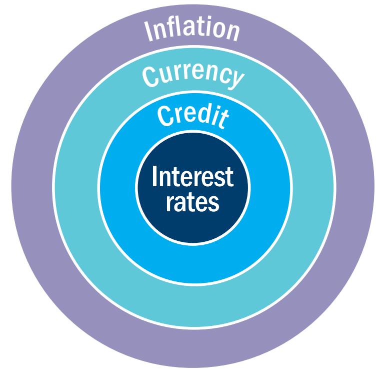
Q: Beyond interest rates, are there other risk factors that affect fixed-income investments?

Interest rates are an important factor to consider when investing in fixed income, but focusing solely on interest rates may leave your portfolio exposed to one-dimensional outcomes. Duration is just one of four risk factors that affect the performance of fixed-income investments. Credit, inflation and currency are the other three risk factors, and different fixed-income investments respond uniquely to each driver.

- **Credit risk** is the possibility of a borrower not making required interest payments on his or her debt (or defaulting on the debt). Credit risk is highly cyclical. Returns generated by credit risk are dependent on risk premiums and the pace of economic growth.

- **Inflation risk** is driven by actual and expected changes in consumer prices. If inflation is high, it can increase prices enough to erode purchasing power and exceed investment returns. Inflation risk performs best when the economy is overheating and prices and wages are rising. This directly benefits inflation-protected bonds, whose value increases as consumer prices rise.
- **Currency risk** represents the return (positive or negative) generated by fluctuations in global exchange rates. Many diversified fixed-income portfolios hold investments in foreign bonds. Currency risk becomes a factor when foreign investments are made using a local currency. Currency changes can be significant and can trend in one direction for months.

Expanding your target for success



The bond market is complex and multi-dimensional. Your fixed-income investments should be too. At Columbia Threadneedle Investments, our fixed-income investment professionals are trained to closely monitor risk factors and adapt portfolios to optimize the effect of various risks on returns.

Work with your financial advisor to determine the effects of changing interest rates on your investments and to determine the best course of action.

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