



Market Comment 12/7/11

The High Cost of Waiting:

In recent months, some investors have been sitting on large amounts of cash in anticipation of a time when interest rates will rise, creating an opportunity for them to put their money to work at higher yields. Often times this approach is directed by an advisor who espouses a similar view.

The cost of waiting for that ideal moment when interest rates spike and one is able to pounce on more attractive yields can end up being quite expensive, as the unfortunate result of this strategy is forgone income and subsequently the missed chance for compounding of that income.

Investors who speculate on the direction of interest rates by waiting for this future “opportunity” may expose themselves to potentially significant opportunity cost and reinvestment risk.

In the first scenario of the following example, \$1 million is invested today in a 10 year muni currently yielding 3.25%. In the second scenario, the \$1 million sits in a money market instrument for a year, and is then invested in a 10 year muni yielding 3.90% - one year from now. This reflects a 65 basis point increase in 10 year muni yields over the course of a year.

Scenario 1

Buy a 3.25% 10yr Municipal Bond now

Scenario 2

Buy Tax-exempt Money Market at 0.01% for 1yr,
then reinvest in a 3.90% 10yr Municipal Bond

Year	Annual Income	Cumulative (A)	Annual Income	Cumulative (B)	Cumulative Cost of Waiting (B minus A)
1	\$32,500	\$32,500	\$100	\$100	-\$32,400
2	\$32,500	\$65,000	\$39,000	\$39,100	-\$25,900
3	\$32,500	\$97,500	\$39,000	\$78,100	-\$19,400
4	\$32,500	\$130,000	\$39,000	\$117,100	-\$12,900
5	\$32,500	\$162,500	\$39,000	\$156,100	-\$6,400
6	\$32,500	\$195,000	\$39,000	\$195,100	\$100

Conclusion:

As you can see, it takes six years for the Scenario Two investor to “catch up” to Scenario One in terms of cumulative income generated by their \$1 million investment. In this case, the strategy of holding cash for an extended period in anticipation of higher yields does not produce the desired result. Indeed, this form of interest rate speculation results in an unfavorable outcome with respect to income generated over an extended period.

Key Indices and Market Data:

- Dow closed at 12150 (+0.43%)
- S&P 500 closed at 1258.47 (+0.11%)
- WTI Crude: \$100.79/barrel (-0.48%)
- Gold: 1725.00 (-0.39%)

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