How Will Higher Rates Affect You?

As you know, interest rates have risen considerably over the past couple of years.

But what does this mean to you, as a consumer and as an investor?

From a consumer's standpoint, it's not hard to see the effects of higher interest rates. If you want to take out a mortgage or refinance an existing one, you'll find that it's considerably more costly, in terms of the interest you'll pay, than it was a few years ago. And the same is true of car loans and credit cards. Paying these debts at higher rates can affect your cash flow, so while rates are high, you may need to make some important decisions about your overall budget and spending plans.

As an investor, though, you may find the effects of higher interest rates to be somewhat more complex. That's because higher rates can have a different impact on different types of investments, such as stocks and bonds.

When considering stocks, be aware that not all market sectors will respond the same way to higher interest rates. For example, the financial sector, which includes banks, insurance companies and brokerage firms, may benefit from higher rates. On the other hand, smaller technology companies, which still must invest heavily in their businesses, may not do as well due to rising interest rates making it more expensive for them to borrow. And other sectors will respond differently to higher rates. Keep in mind, though, that there's great variance within sectors and among companies, so when you consider purchasing stocks, evaluate each choice on its merits and make sure it fits within your risk tolerance, time horizon and need for portfolio diversification. When you diversify your investment dollars, you can reduce the risk of market volatility affecting just one type of asset, although diversification by itself can't protect against all losses.

With fixed-income investments, such as bonds, interest rate movements can have significant and direct impacts. When interest rates rise, the value of your current bonds will likely fall because new bonds can pay higher rates. However, you can also buy bonds at the new, higher rates and benefit from bigger interest payments.

Still, there's no guarantee that interest rates will stay elevated – in fact, the Federal Reserve has indicated that it might actually start cutting rates in 2024 – which is why it may be a good idea to build what's known as a "ladder" consisting of short-, intermediate- and long-term bonds. Once you have your ladder in place, you'll have some protection from interest-rate movements. So, if rates were to keep rising, you could reinvest the proceeds of your short-term bonds in the new, higher-paying ones. But if rates level off, or even fall, you'll still benefit from your longer-term bonds, which typically (but not always) pay higher rates than short-term ones.

Of course, if you hold your bonds until maturity, you will continue to get the same interest payments, regardless of where market rates go.

In any case, it's useful to be aware of what's happening with interest rates — the more you know about the factors affecting your investments, the better off you'll be.

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