

Profitable INVESTING Tips

Stock Market Investing Tips, Techniques, and Resources



How to Profit from Higher Interest Rates

The Federal Reserve is expected to raise interest rates again. *The New York Times* writes that the question is **not why raise rates but why not.**

The unemployment rate, one of the gauges the Fed watches most closely, fell to 4.7 percent in February, a healthy level by historical standards. Inflation, the other gauge, finally appears to be reviving. Prices rose 1.9 percent over the 12 months ending in January, close to the Fed's 2 percent annual target.

The Fed continues to hold its benchmark interest rate at a level intended to stimulate economic growth by encouraging borrowing and taking risks. It sits in a range from 0.5 percent to 0.75 percent.

Everyone wants to expand the economy. The Trump market rally is based on the expectation of lower taxes, fewer regulations, repatriation of offshore corporate cash and infrastructure spending. But is that what it takes to make the economy hum?

The government estimates that the economy grew just 1.6 percent in 2016, compared with 2.6 percent in 2015. Moreover, private economic forecasters don't see signs of an acceleration in the first quarter of 2017.

But the most important factor is the slow pace of productivity growth.

There are only two ways to expand an economy: add workers, or get more out of every worker. The domestic work force is growing slowly, and lately, so is productivity. Low interest rates can't fix either problem.

Thus the Fed will likely deal with inflation by raising rates at a measured pace and leave economic stimulus to the administration and congress. And how do you profit from higher interest rates?

How to Profit As Interest Rates Go Up

The Motley Fool has a few suggestion of how to **profit from rising interest rates.**

Create a Bond Ladder

This is not a good time to lock money into long-term fixed-income instruments such as Treasury bonds. Build a portfolio of short-term notes that will periodically come due, perhaps a month after each meeting of the Federal Reserve.

Buy Treasury Inflation Protected Securities

These special bonds are backed by the full faith and credit of the U.S. government. They pay a fixed rate of interest twice each year, and the principal in them is also adjusted for on a semiannual basis. The government makes this adjustment based upon changes in the Consumer Price Index (CPI), which is widely considered the best indicator of inflation.

Invest in Banks and Financial Service Companies

The financial industry always profits when interest rates start to rise, as this means they can charge higher interest rates on loans and other financial products.

Take Capital Losses from Bonds and Bond Funds

Bond prices will start to fall in the secondary market when interest rates start to rise. This may offer a good opportunity to realize some capital losses in your fixed-income portfolio. These losses can be netted against any taxable capital gains that you realize during the year and also against other forms of income within certain limits, which will lower your overall tax bill.

To the extent that you expect rates to go up rapidly you will want to sit on cash or cash equivalents as longer term investments like solid **dividend stocks** come down in price to where they are a good deal.

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