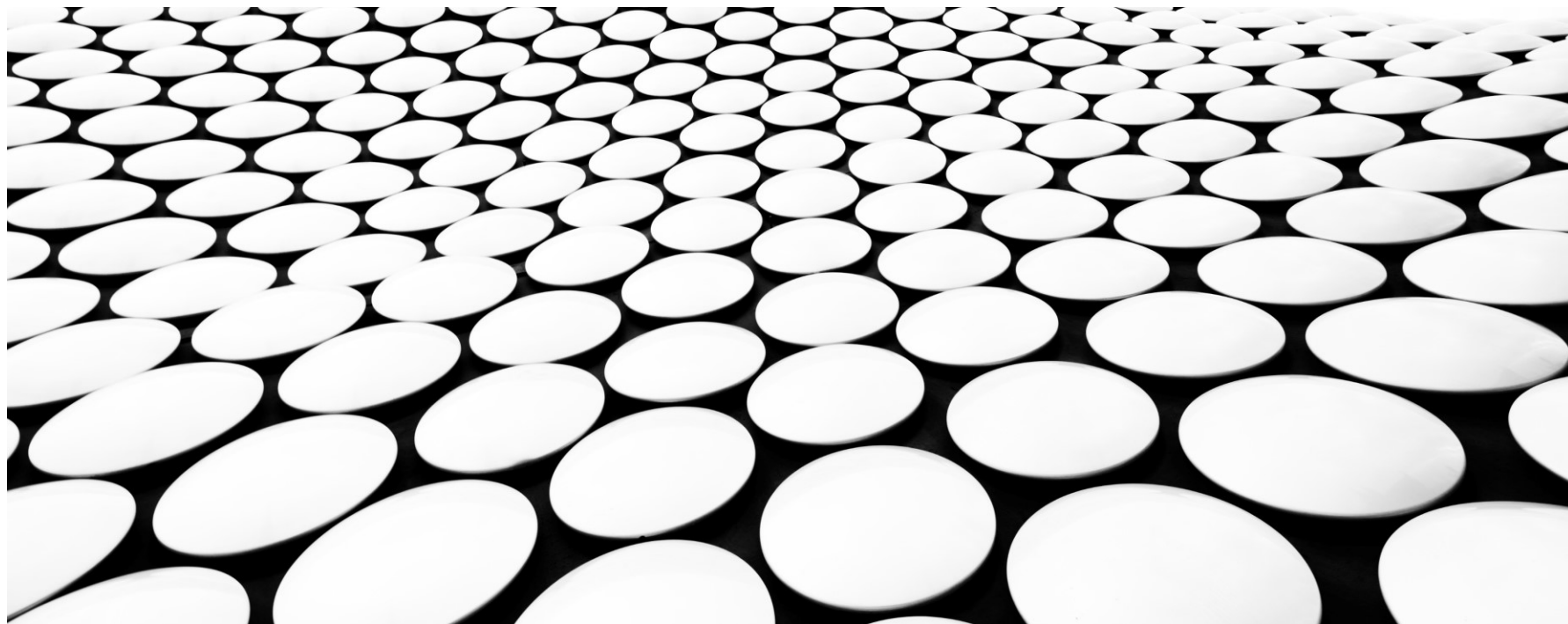

Fixed Income Alternatives in a Low-Yield Environment

Harry Sit | April 10, 2021





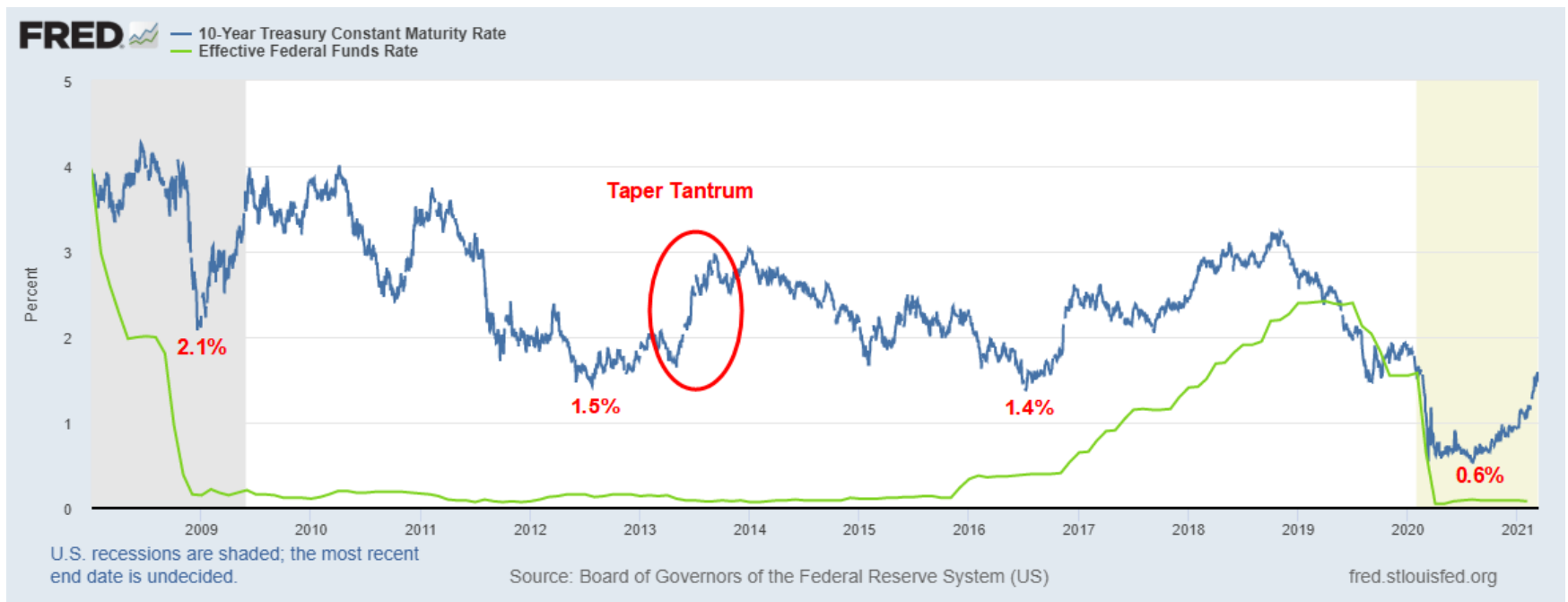
Disclaimer

- Not an investment professional
- Only personal opinion from DIY experience
- No relationship with any company mentioned except as a customer

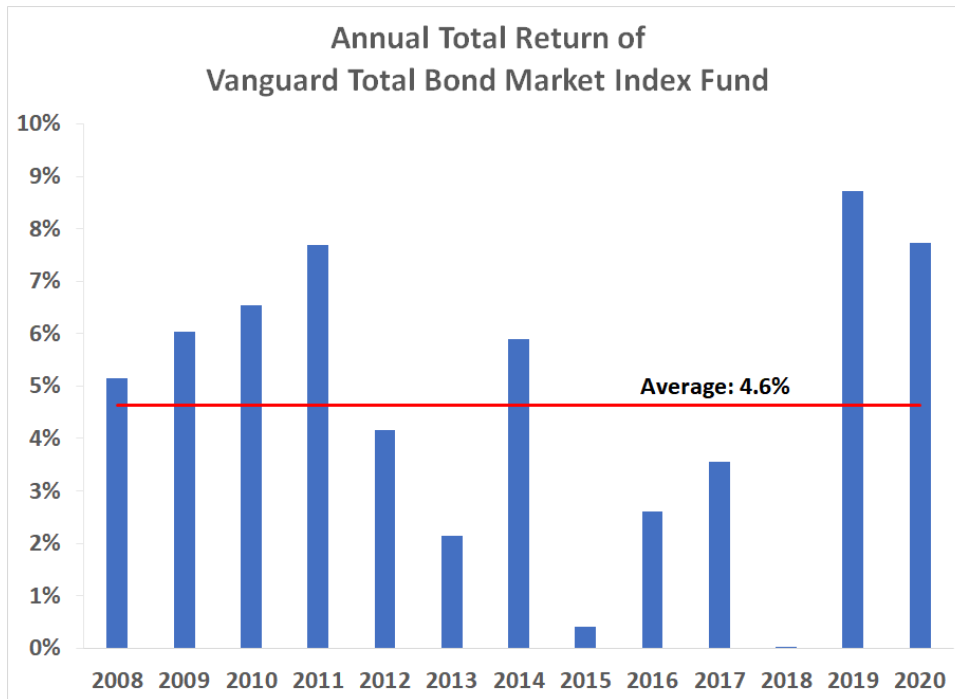
Bond Yields Went Lower and Lower

“We’re not thinking about raising rates. We’re not even thinking about thinking about raising rates.” — Fed Chair Jerome Powell

“Fed expects to keep its key rate near zero through 2023” — AP



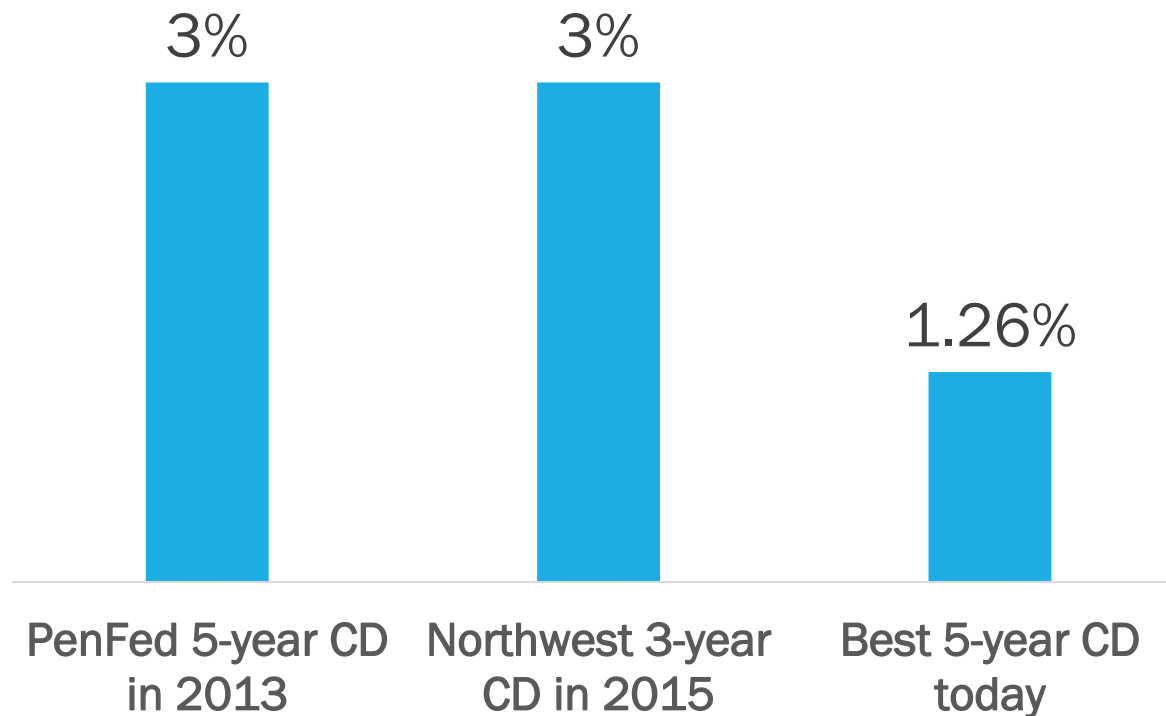
Default Option — “Stay the Course” in Bond Funds



- Yield is low because institutional investors accepted high prices
- Good returns in recent years despite low yields
- Liquid, easy to rebalance
- **Low expected returns going forward**

Look for Opportunities Unique to Retail Investors

- Direct CDs in previous years — but banks and credit unions are awash in cash today



1. Refinance / Prepay Mortgage

- Mortgage rates are low but still higher than safe bonds
- Limit on SALT deduction made ~90% use the standard deduction – mortgage interest effectively not tax deductible
- Your home doesn't know whether you have a mortgage
- More resilient to loss of income without mortgage payments
- Psychological benefits from owning the home free and clear
- Only use taxable money to prepay mortgage
- Must maintain adequate liquidity

Refinance / Prepay Mortgage



2. Fixed Deferred Annuity / Multi-Year Guaranteed Annuity (MYGA)

- Contract issued by an insurance company
- Guaranteed fixed interest rate for a fixed term
- Higher interest rate than bonds and CDs
- Not guaranteed by any government agency
- High early withdrawal penalty (“surrender charge”)
 - Example: 9% plus market value adjustment if withdrawn in the first year
 - Can't use for rebalancing
- Individual contracts. Not available as a fund.

MYGA – Interest Rates

	3-Year	5-Year	7-Year
A++	1.60%	2.10%	1.60%
A+	1.90%	1.75%	2.25%
A	1.95%	2.70%	2.30%
A-	1.95%	2.55%	2.80%
B++	2.25%	2.80%	2.90%
CD	1.01%	1.26%	1.50%
Treasury	0.31%	0.85%	1.32%

- Product availability and rates vary by state. In general, higher interest rate from lower-rated insurers and for longer term.
- Must decide whether it's worth the risk and poor liquidity

MYGA – Qualified and Non-Qualified

- Qualified – use money in existing Traditional or Roth IRA
 - Transfer IRA to insurance company. Transfer back after term ends.
 - Maintain IRA characteristics
- Non-Qualified – use money in taxable account
 - No tax deduction, not limited by annual IRA contribution limit
 - Earnings are tax-deferred. Tax penalty on earnings withdrawn before age 59-1/2 (10% federal + 2.5% CA).
 - After term ends, withdraw and pay taxes on earnings or continue to defer via 1035 exchange to another product
 - Can't roll over into an IRA



MYGA – State Guarantee Association

- Not guaranteed by any government agency
- State-specific private industry association provides some level of guarantee in case an insurance company fails
- Guarantee limits vary by state. Go by the rules of the state of residency at the time of failure. Insurance company must be licensed in that state.
- California (www.califega.org): 80% of the present value up to a maximum of \$250,000 per person

MYGA – Withdrawal Before Maturity

- Withdrawal allowance and surrender charge vary by product
- Examples – limited early withdrawal without surrender charge
 - Can withdraw accrued interest; or
 - Can withdraw 10% of the value once a year
- Surrender charge applies on withdrawals above the allowance
 - Example: 9% in year 1, 8% in year 2, 7% in year 3, ...
- Market Value Adjustment (MVA) based on interest rate changes may also apply
- Some products give full value to beneficiary if the owner dies

MYGA – Options When The Term Ends

- Some products auto-renew. Some don't.
- Set calendar reminders 30 days before the end of the term
 - Transfer back to brokerage IRA (qualified MYGA only)
 - Renew to another MYGA at the same company
 - 1035 exchange to another insurer

MYGA – Where to Buy

- [Fidelity](#) and [Schwab](#) – not available through Vanguard
 - Products from select A+ and A++ rated insurance companies
 - Convenient but not the highest rates
- [Blueprint Income](#), [Stan The Annuity Man](#), [ImmediateAnnuities.com](#)
 - Online agent representing multiple companies
- [Gainbridge](#) and [Canvas](#) – **not available in California**
 - Captive agent selling products from a single insurance company
- Brick-and-Mortar life insurance agents

MYGA – Purchasing Process (Qualified)

- Online application with high-level financial profile
- Phone call to confirm suitability
- DocuSign/email scanned forms. Move to cash in IRA.
- Insurance company sends partial IRA transfer form to broker. Broker processes transfer.
- Insurance company issues contract, forwarding through agent
- Several weeks from start to finish. Rate locked when insurance company received application.



MYGA – Tracking Account Values

- Some insurance companies have a client portal. Some don't.
- Predictable values by printout or spreadsheet
- Insurance company sends Form 5498 with end-of-year value (qualified only)
- Ask agent



MYGA – Considerations

- Part of diversified fixed income holdings. Only use money you're sure you won't need before the term ends.
- Trade-off between insurance company rating and yield
- Fully understand the terms before applying. Don't assume.
- Have an exit plan
- Diversify among different insurers and terms

MYGA – Further Reading

- [Fixed Annuity](#) on Bogleheads Wiki
- [MYGA notes](#) by *EvelynTroy*
- Search for “MYGA” on Bogleheads Forums

Fixed Deferred Annuity / Multi-Year Guaranteed Annuity (MYGA)



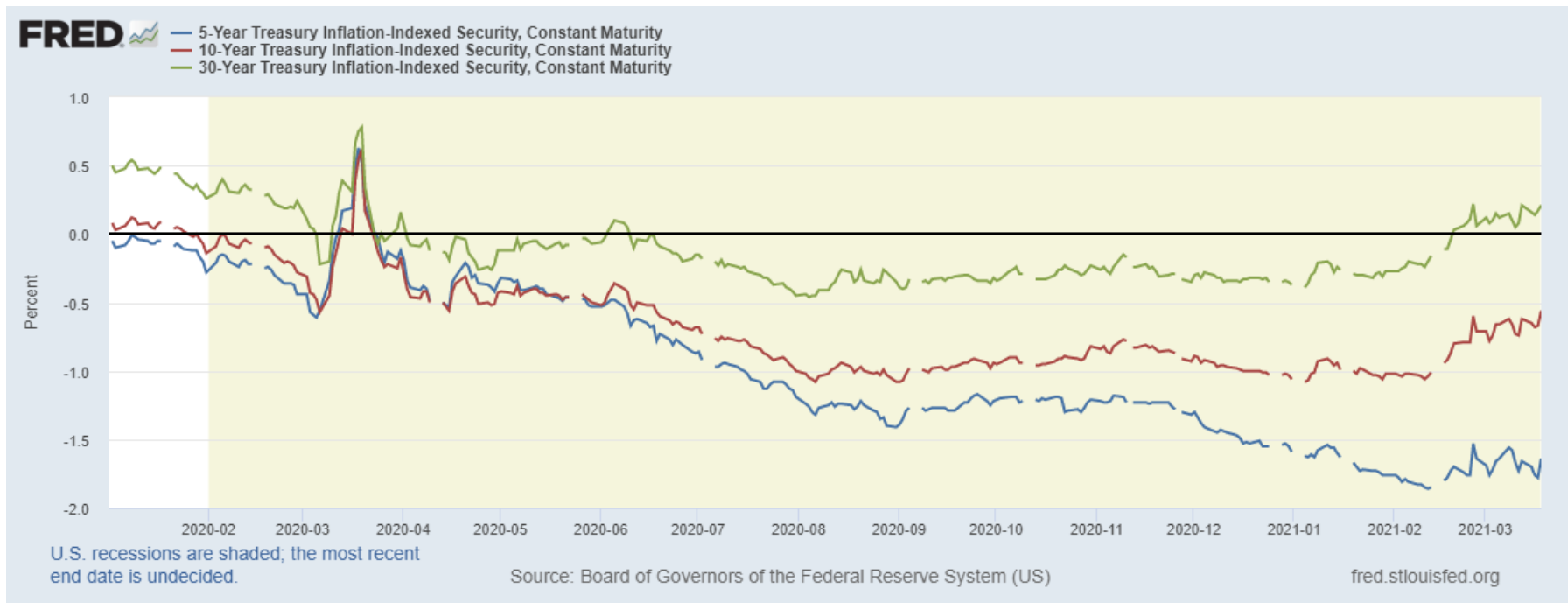
3. Series I Savings Bonds (“I Bonds”)

- Issued by U.S. government directly to individual investors
 - Not available through any 3rd party (bank, broker, ...)
- Flexible term 1 – 30 years
- Guaranteed to match inflation
- Can only use taxable money. Not available in IRA.
- Low annual purchase limit. Must build positions over time.

I Bonds — Rates

- Fixed rate + inflation adjustment
- Fixed rate announced May 1 and November 1 each year for new purchases
 - Fixed rate is fixed for the life of the bonds after purchase
 - Fixed rate does not go below zero
- Inflation adjustment changes in six-month cycles
 - CPI-U changes March – September and September – March
- Composite rate also does not go below zero
- Current rate for new purchases: 0% fixed + inflation

I Bonds — Matching Inflation Is Better Than Losing



I Bonds – Ownership Types

- Not available in IRA
- Individual owner
- Primary Owner + Co-owner
- Owner + Beneficiary
- Entity/Trust

I Bonds — Terms

- No redemption allowed in the first 12 months
- Redeem at any time after 12 months
- 3-month interest penalty if redeemed within 5 years
- Interest is tax deferred. State income tax free.
- Tax-free redemption + contribution to 529 plan
 - Still subject to 529 plan contribution limits

I Bonds – Annual Purchase Limit

- \$10,000 per calendar year per Social Security Number as the primary owner
- \$10,000 per calendar year per entity/trust account
- \$5,000 per tax return using tax refund
 - Pay extra with extension to increase available tax refund ([IRS Direct Pay Form 4868](#))
 - Paper bonds come in the mail – can consolidate into online account
- Think of it as an account – higher than IRA contribution limit

I Bonds — TreasuryDirect.gov

- Not the most user-friendly website but functional
- Purchase and redeem
 - Link bank account
 - Separate login for each primary owner
- Check holdings — no monthly/annual statements
- Mail in paper bonds to consolidate into online account
- Print 1099-INT form in the year after redemption
 - TreasuryDirect does not mail tax forms

I Bonds — Considerations

- No-brainer — current fixed rate is higher than TIPS yield paid to institutional investors
- Flexible holding period after one year
- Max out annual purchase limit
 - Single — \$10,000 + \$5,000
 - Married — \$10,000 + \$10,000 + \$5,000
 - Additional purchase for trust

I Bonds – Further Reading

- [I savings bonds](#) on Bogleheads Wiki
- [Series I Savings Bonds](#) on TreasuryDirect.gov
- [Guided Tour](#) on TreasuryDirect.gov
- [Overpay Your Taxes to Buy I Bonds for a Better Yield Than TIPS](#) on my blog
- [Converting Paper Savings Bonds to Electronic Form](#) on TreasuryDirect.gov
- Search for “I Bonds” on Bogleheads Forums

Series I Savings Bonds (“I Bonds”)



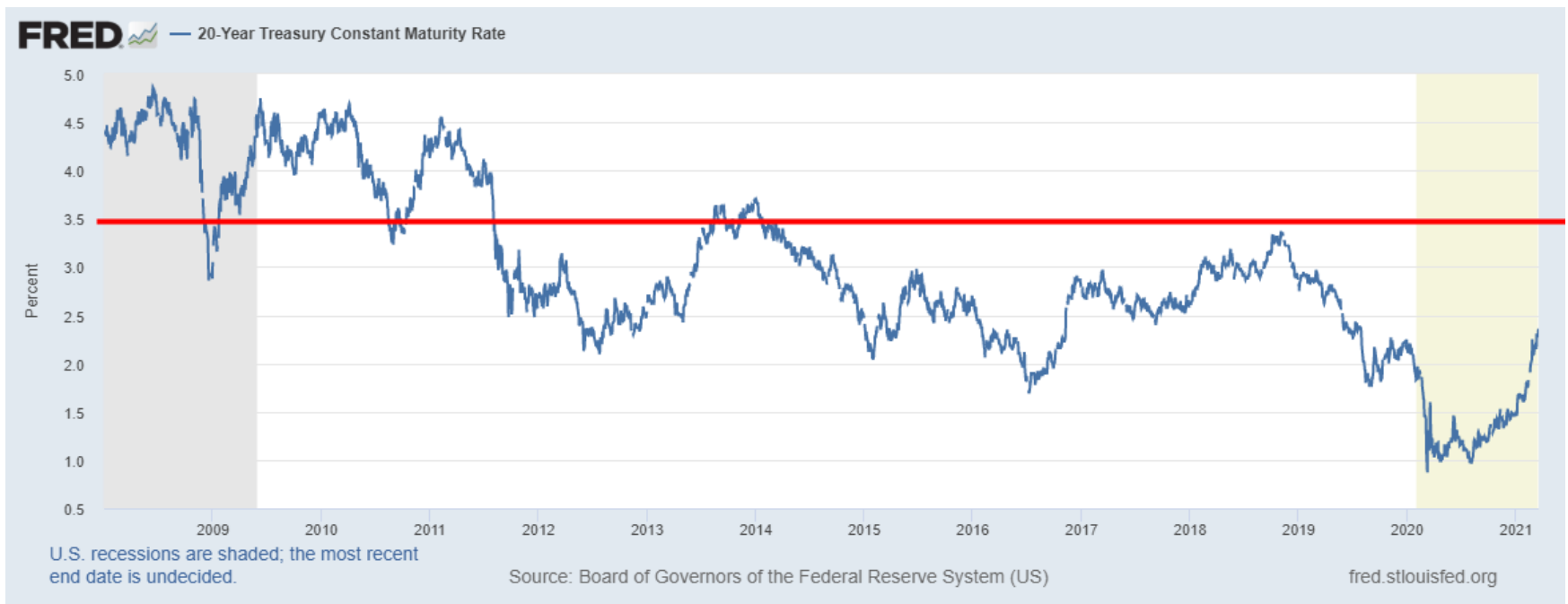
4. Series EE Savings Bonds (“EE Bonds”)

- Issued by U.S. government directly to small investors
 - Not available through any 3rd party (bank, broker, ...)
- 3.53% annual return if holding for 20 years
 - 20-year Treasury yield: 2.27% as of March 26, 2021
- Can only use taxable money. Not available in IRA.
- Only makes sense if holding for 20 years
- Low annual purchase limit. Must build positions over time.

EE Bonds — Rates

- Fixed rate for 20 years, currently 0.1%
- One-time adjustment to double the value at the 20-year mark
- Equivalent to 3.53% annual return for 20 years
- Large early withdrawal penalty
 - Value per \$100 at 20 years: \$200
 - Value per \$100 at 19 years: \$102

EE Bonds — Versus 20-Year Treasury



EE Bonds — Ownership Types

- Not available in IRA
- Individual owner
- Owner + Co-owner
- Owner + Beneficiary
- Entity/Trust

EE Bonds — Terms

- No redemption allowed in the first 12 months
- Can redeem between 1 - 20 years but will pay a huge penalty
- Resume low rate after 20 years
- Interest is tax deferred. State income tax free.



EE Bonds — Annual Purchase Limit

- \$10,000 per calendar year per Social Security Number as the primary owner
- \$10,000 per calendar year per entity/trust account
- Not available using tax refund
- Separate purchase limits for I Bonds and EE Bonds
- Think of it as an account — higher than IRA contribution limit



EE Bonds — TreasuryDirect.gov

- Use same account for I Bonds and EE Bonds
- Purchase, check holdings, redeem, print tax form

EE Bonds — Considerations

- Only use money you're sure you won't need for 20 years
 - Not as flexible as I Bonds. Can't use for rebalancing.
- Build a ladder as a mini pension
 - Example: Buy each year after age 40. Start redeeming at age 60.
- Expected to beat inflation at current rates but still has inflation risk
 - 20-year Treasury yield: 2.27%. 20-year TIPS yield: -0.17%.
- Remember to redeem at 20 years!

EE Bonds — Further Reading

- [EE savings bonds](#) on Bogleheads Wiki
- [Series EE Savings Bonds](#) on TreasuryDirect.gov
- Search for “EE Bonds” on Bogleheads Forums

Series EE Savings Bonds (“EE Bonds”)





Additional Comments & Questions

thefinancebuff.com/contact