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THE CURRENT CD QUANDARY

Today's yields can't beat inflation.

CD investors are effectively losing money. According to Market Rates Insight, a research firm tracking bank rates, annualized inflation has surpassed long-term certificate of deposit rates since February. In April, 12-month inflation hit 3.16% while the highest-yielding 5-year callable CD on the market offered a 2.4% interest rate. May's Consumer Price Index put annualized inflation at 3.6%; as of mid-June, the highest-yielding nationally available 5-year CD was at 3.05% APY.^{1,2,3}

Still, the Federal Reserve found that almost \$9 trillion of American wealth was held in CDs, bank accounts and various FDIC-insured products as of April.⁴

It's a case of déjà vu. This is the second time in recent history that CD investors have been punished for assuming so little risk. During the period from January-July 2008, the negative yield on 5-year CDs was 1.8% according to MRI.⁵

They might come out ahead ... should inflation diminish. As Bankrate.com senior financial analyst Greg McBride reminded Bloomberg, "Investing in a CD isn't compensating you for last year's inflation; it's compensating you for next year's inflation, which is unknown." Will inflation ease in the long term? Many analysts aren't betting on it.

The appeal of CDs remains strong. After all, not many investments are federally insured. MRI vice-president Dan Geller said it best to Bloomberg: "Right now, people are more concerned about the return of their deposits rather than a return on their deposits."

With 63% of Americans still believing the nation is in a recession (according to a recent Rasmussen Reports poll), there is still plenty of skittishness about equity investment. Even with the Fed's bond-buying campaign sending yields on short-term Treasuries and CDs toward all-time lows, some investors really aren't hungry for risk.⁵

Are CDs still worth it? There is no pat answer. Your own answer will depend on your preferred investment style, your risk tolerance and your financial objectives. Many people choose to park some of their invested assets in CDs and other savings instruments as part of a diversification approach. The inflation-adjusted return is dismal at the moment, but knowing that your principal is safe certainly has its appeal.

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Citations.

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