



“On The Money Report”

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New Investments From The U.S. Treasury.

The U.S. treasury is going to issue new Treasury Inflation Protected Securities (TIPS) with maturities of 5 and 20 years beginning July and October, 2004. Current TIPS carry 10 year maturities.

The reason for the change is that investor interest is rising and more money is moving in to these types of securities. In addition, more mutual funds are being created to meet demand for bonds that protect against rising inflation.

Advantages and Disadvantages.

How they work.

An investor gets a guaranteed rate of interest. When the investor cashes in the bond, the principle value is adjusted upward to reflect the impact of inflation over the period of time. Even if we experience deflation, the bond investor is assured of getting back original principal. In this way, the total return on the bond will keep pace with inflation.

TIPS are also exempt from state and local taxes. This may represent significant tax savings to individuals in high-tax states but is not a problem for Florida residents.

This inflation protection comes at a cost, however. The yield on the conventional 10 year treasury is now about 2.5% higher than the TIPS. If inflation rises more than that you will be big winner, if it doesn't you're better off with the conventional treasury.

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It is also important to consider the tax consequence on the earnings of a TIPS.

The monthly interest is taxable as normal interest but the amount annually added to the principle is also taxable. This means you will have to pay taxes each year on cash you have not received. That is why most advisers think it is better to hold these in tax-advantaged accounts like IRA's and 401(k)s.

Another less recognized concern comes from the fact that the inflation adjustment is based on the monthly change in the Consumer Price Index (CPI). It is my opinion that this index significantly understates the real rise in the average person's cost of living. If this continues, the inflation adjustment won't be enough to offset the increase in future living expenses.

Where To Buy Them

You can buy these bonds directly from the Treasury at www.treasurydirect.gov or through numerous mutual funds.

When choosing a mutual fund, look carefully at the fund's internal expenses. There isn't much investment return to go around so the amount you shell out for the fund's expenses will come directly off your return.

Buy the fund with the least annual expense charge and watch out for “up-front” sales loads (A shares) or deferred sales charges (B or C shares). These will take a big bite out of your return.



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Five Funds To Consider

	Expenses*
Vanguard Inflation Protected Securities (VIPSX)	.22%
Fidelity Inflation Prot Securities (FINPX)	.50%
American Century Inflation Adjusted Bond (AIAVX)	.76%
PIMCO Real Return A (PRTNX)	.91%
Hartford Inflation Plus (HIPAX)	1.00%

Steve

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*Source: Morningstar

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