
R.O.I.
By BRETT ARENDS

# With TIPS Like These, Investors Need Advice

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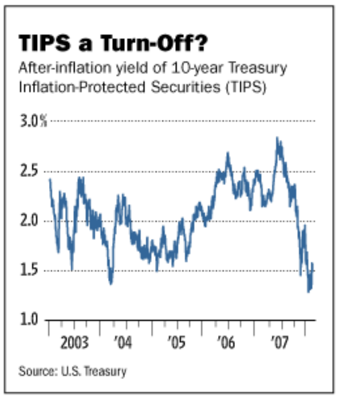
Inflation's a big risk to your savings. But inflation-protected bonds are an even bigger risk these days.

As fresh data showed yesterday, consumer prices are rising faster than expected, even while the economy sags. Many investors, and their financial planners, are reacting to the danger by rushing into what they think is a safe haven: Treasury inflation-protected securities or TIPS.

It's a bad move.




The bidding frenzy has sent TIPS prices soaring. The bonds have become wildly overvalued and now offer a terrible long-term bet.

In theory, TIPS are an excellent idea. Like all bonds issued by Uncle Sam, they are safe from default. But unlike other Treasurys, they are also supposed to be safe against rising prices as well. They offer a certain guaranteed "real" yield on top of the official consumer-price index. So if inflation rises, the yield rises to match.

The problem? The guarantee that can make these bonds a fortress for your money can also make them a prison. This "real," or after-inflation, yield is locked in when you buy the bond.

And right now, those real yields are terrible. They recently touched record lows.

The real return on the 10-year TIPS is just 1.56%, according to the Treasury's latest data. Recently, it sank as low as 1.31%.

For the seven-year bond it's just 1.23%, and for the five-year, a crazy 0.78%.

Early last fall, long TIPS guaranteed a respectable 2.3% plus inflation. At the time, I wrote that they appeared to be a much better bet than regular long-term bonds. And so it has proven.

But today they look abysmal. For most investors, the actual returns will be even worse.

First, individual TIPS are quite-complex products, and most investors will own them through a fund rather than directly. And the funds' fees will slash these minuscule yields still further.

Vanguard's most-recent data put the "real" yield on its inflation-protected securities mutual fund, after fees, at 0.8%.

And that's a low-cost fund. Expenses are just 0.2%.

Imagine what is left for investors in a regular bond or balanced mutual fund that puts money in TIPS. Most do. And they charge fees of 1% a year or more.

The second problem with TIPS is that many investors will hold their funds in a taxable account. And that can end up being a long-term disaster. An illustration: Imagine inflation rises to 5%. Your 10-year TIPS, with its 1.56% "real" yield, will therefore pay 6.56%.

But that's taxable. At the top 35% rate of federal income tax, you will actually get only 4.26% a year.

And that, of course, is well below the inflation rate. A guaranteed negative real return. In this scenario, only those below the 25% federal tax rate come out ahead.

Combine taxes and fund fees, and the numbers become even worse.



Especially for those unfortune souls who invested at yields down to 1.31%.

As a general rule of thumb, TIPS are usually worth looking at only when the real yield on the 10-year rises well above 2%.

This column doesn't try to predict short-term market movements. The fact that Wall Street may be doing something really foolish today doesn't mean it won't do something even more foolish tomorrow.

So for all I know, TIPS could soar still further in the weeks ahead until they actually guarantee a negative real yield for everybody.

But that doesn't mean you have to join in. As a long-term investment for serious individuals, TIPS right now look absurd.

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### ABOUT R.O.I.

Brett Arends writes R.O.I., or Return On Investment, daily for the Online Journal, dissecting where personal finance meets current affairs, and how the latest news can make you money."

A lot of the time, that comes from going against the herd.

Brett has spent his life rifling through department store bargain bins in London, Boston and New York, and that's pretty much the same way he views markets. A good stock-market panic yields the cheapest deals. And there's only one thing better: a scandal. That's when you get a firesale. R.O.I. will be looking for bargains anywhere, and for opportunities on the spending side as well.

It isn't really true that $1,000 saved is just $1,000 earned. If you're in the top income-tax bracket, it's $1,500 earned. And salted away for 30 years in a tax-deferred account, $1,000 saved is nearly $9,000 towards your retirement. That's some return.

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