Amherst Financial Training

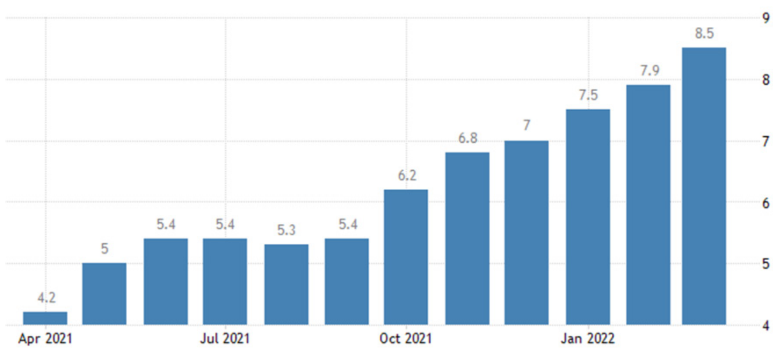
I-Bonds: An Investors Primer

by William Addiss

Author's Confession: As someone who has been involved with the bond market for 40 years, I confess I-Bonds have not been on my radar screen until recently. I considered these "savings certificates" to be akin to the Series E Savings certificates I received as a child from grandparents on special occasions and collected dust in a desk drawer for years. Additionally, "Wall Street" pays no attention to these, as they are designed for retail individuals, with no fee, trading, or "mark-up" opportunities.

That said, presently I-Bonds offer an incredible government backed coupon of over 9% (at a time when the highest yield available on traditional treasury bills, notes or bonds is 3%). However, they require a bit more of an understanding, as these are floating rate investments. In this case the rate of return is tied to the Inflation rate. As inflation rises, (as it has been), the rate of return rises. Similarly, should we experience deflation, the rate will drop.

Turning Lemons into Lemonade: As the enclosed chart shows, inflation (Consumer Price Index-CPI) here in the US has risen dramatically over the last year. We are now experiencing the highest levels of inflation in almost 40 years. These I-Bonds base their rate of return to that same CPI rate. Semi-annually, these bonds adjust their coupon to reflect this increase in inflation. Because of the dramatic rise in inflation, the most recent coupon adjustment for the period of April 30 -Nov 30 is 9.3! In November, the coupon will once again reset to reflect the changes in CPI for the next 6-month period. Of note: there is technically a fixed rate that is reset semi-annually, in addition to the floating CPI component. However, for the past year the Treasury Secretary has opted to make the fixed component 0, as the floating rate is so historically high (and attractive to the investor).



Understanding the Liquidity (or lack of) in I-Bonds:
I-Bonds are sold with 30-year maturities. However, the Treasury Dept does offer redemption features. Please note: unlike traditional treasury securities, these I-Bonds cannot be resold in the secondary market prior to maturity. Should you seek to redeem them, the Treasury Dept. offers the following redemption provisions:

- Within the first year: No redemptions possible: "locked in" for 1 year
- Years 2-5: Redemption with 3-month interest penalty
- After 5 years: Redemption available with no penalty

How to Purchase I-Bonds: This is a security specifically for the retail investors. They can be purchased directly from the treasury department, and as an investor, you pay the face value of the bond. For example, you pay $50 for a $50 bond. (The bond increases in value as it earns interest.)

Electronic I-Bonds: Are purchased directly from the treasury department, where you can buy an dollar amount up to $10,000 per year. For example, you could buy $50.65 in I-Bonds.
Paper I-Bonds are sold in five denominations: $50, $100, $200, $500, $1,000. Interestingly, paper I-Bonds are only available if using federal tax refunds to buy the bonds.

To Learn More
The website where investors can buy I-Bonds, as well as learn more of the details:
https://www.treasurydirect.gov/indiv/research/indepth/ibonds/res_ibonds.htm