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# False Sense of Securities

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It's March 2000 all over again. But this time frenzied buyers aren't focused on stocks.

For the past few months, if not the past few quarters, many investors have gotten fed up with stock returns. Additional concerns over war with Iraq and its ramifications have sent many seeking the safety of U.S. Treasury bonds. Just a few days ago, the yield on the 10-year Treasury Note fell to near 3.5%, its lowest in decades.

Prudent? In late 1999 and early 2000, stock jockeys loaded up on technology companies many of which were losing money hand over fist. So what are people doing today? Instead of buying stocks with no earnings, folks are purchasing bonds with hardly any yield. (If you buy these bonds at their current coupon rate and hold them until maturity, after inflation and taxes, your real return will be next to nothing or even negative!)

If you buy these U.S. government bonds, which carry an inherent high sensitivity to interest rates, through mutual funds, such as Fidelity Government Income, you could suffer stinging short-term losses if interest rates rise, driving bond prices lower. For instance, if interest rates climb one percentage point over the next six months, 10-year Treasury Notes will lose six to eight percent even after figuring in the interest bond holders would collect.

Interest rates may have a little further to drop in the near-term, especially if geopolitical events or economic fundamentals take a turn for the worse. However, as geo-political issues get resolved and President Bush's fiscal stimulus enters the U.S. economy later this year - spurring economic growth and growing the federal deficit, interest rates have a good chance of rising.

We recommend investors be wary of interest rate sensitive bonds, such as U.S. Treasuries, going forward. We prefer high yield bonds (Fidelity Capital & Income, Fidelity High Income, T. Rowe Price High Yield, Pioneer High Yield, and Fidelity Floating Rate High Income) in today's environment. (See our article "Investing in Junk Bonds" posted to the site at the end of 2002). However, all types of bonds have risk, whether it is sensitivity to interest rates, default, credit risk, or purchasing power (inflation) risk. Even income investors should hold a diversified, albeit extremely conservative portfolio, rather than simply relying on the false sense of security of bonds.