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TIPS
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Treasury inflation-protected securities, or TIPS, are bonds whose principal increases at the same rate as inflation as measured by the Consumer Price Index. First offered in 1997, these inflation-adjusted bonds have now found their way into many portfolios and many 401(k) plans, including General Motors, Ford, Chrysler, Delphi, and Visteon. **PIMCO Real Return Fund** and its institutional equivalent, **PIMCO Real Return Strategy Fund** hold billions of dollars of TIPS.

Bonds become an important part of a diversified portfolio in a slowing economy because their prices tend to rise as interest rates are falling. However, the enemy of bonds is inflation because inflation diminishes the purchasing power of fixed interest and principal payments. Treasury Inflation Protected Securities counter this purchasing power risk.

Why are we worried about inflation in a slowing economy? Because there are other dynamics at work in this economic cycle. U.S. growth is clearly slowing, exacerbated by the financial crisis that originated last year in the subprime-mortgage market. The Fed has cut interest rates drastically already this year to help spur growth and aid the liquidity crisis. These rate cuts run the risk of increasing inflation down the road.

Additional inflation risks abound. Stronger growth in developing countries, such as China and India, will have an impact. Oil prices continue to bounce higher, reaching $110 per barrel in the first quarter. A weaker dollar is boosting the costs of imports.

Still other factors are buffeting TIPS. The credit market seizure has driven many fixed income investors to only the safest assets. TIPS eliminate just about any risk an investor can imagine, besides the government going broke.

TIPS have been the fixed income stars of the first quarter, primarily as a result of the rapid interest rates cuts by the Fed as well as a dash of safe-haven investing amid the credit chaos. With inflation expectations rising, TIPS are an attractive investment.