

The changing outlook on retirement

(R-5/2019)



Does your portfolio have too much interest rate risk?

Why are bonds often chosen for a retirement strategy?

Bonds can contribute an element of stability to almost any portfolio.

They can also help provide you with:

- **Diversification** – In an attempt to diversify their retirement savings, people often purchase bonds which tend to be less volatile than stocks. Diversification does not ensure a profit or protect against loss.
- **Stability** – The majority of the returns come from interest payments; fluctuation in the price of the bond has little impact on the interest or income they produce.
- **Tax benefits** – Payments from some bonds are exempt from federal or state taxes.

Bonds are commonly considered to be less volatile than stocks – however, **bond investments are not without risk.**

In recent history, many people changed from investing in the stock market to investing in bonds as a safer alternative, with the intention of once again investing in the stock market when interest rates rise. However, if you're counting on bond investments (also called fixed-income investments) to generate retirement income or accumulate assets for retirement, you could find that their value has fallen when it's time for you to reinvest in another bond.

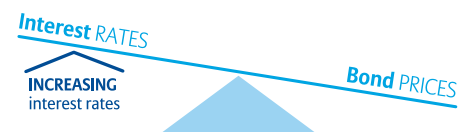
If you're depending on a certain amount of bond investment income, getting a lower yield could result in lowering your standard of living.

What contributes to volatility in bond values?

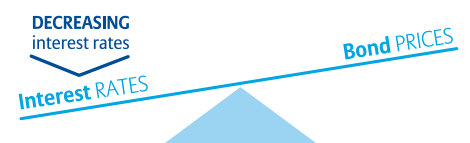
Many factors impact bond prices, one of which is the inverse relationship bond prices have with interest rates. Longer-term bonds tend to be more sensitive to interest rates since there is more time for rates to fluctuate.

Bond funds are subject to credit risk and inflation risk.

GENERALLY, WHEN INTEREST RATES GO UP, **BOND PRICES GO DOWN:**



ON THE OTHER HAND, WHEN INTEREST RATES DECLINE, **BOND PRICES RISE:**



The question is, which of these two scenarios is more likely to happen in the future?

Look inside for more on how you could be affected.

For all that's ahead.®

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How would a rising interest rate environment affect your portfolio?

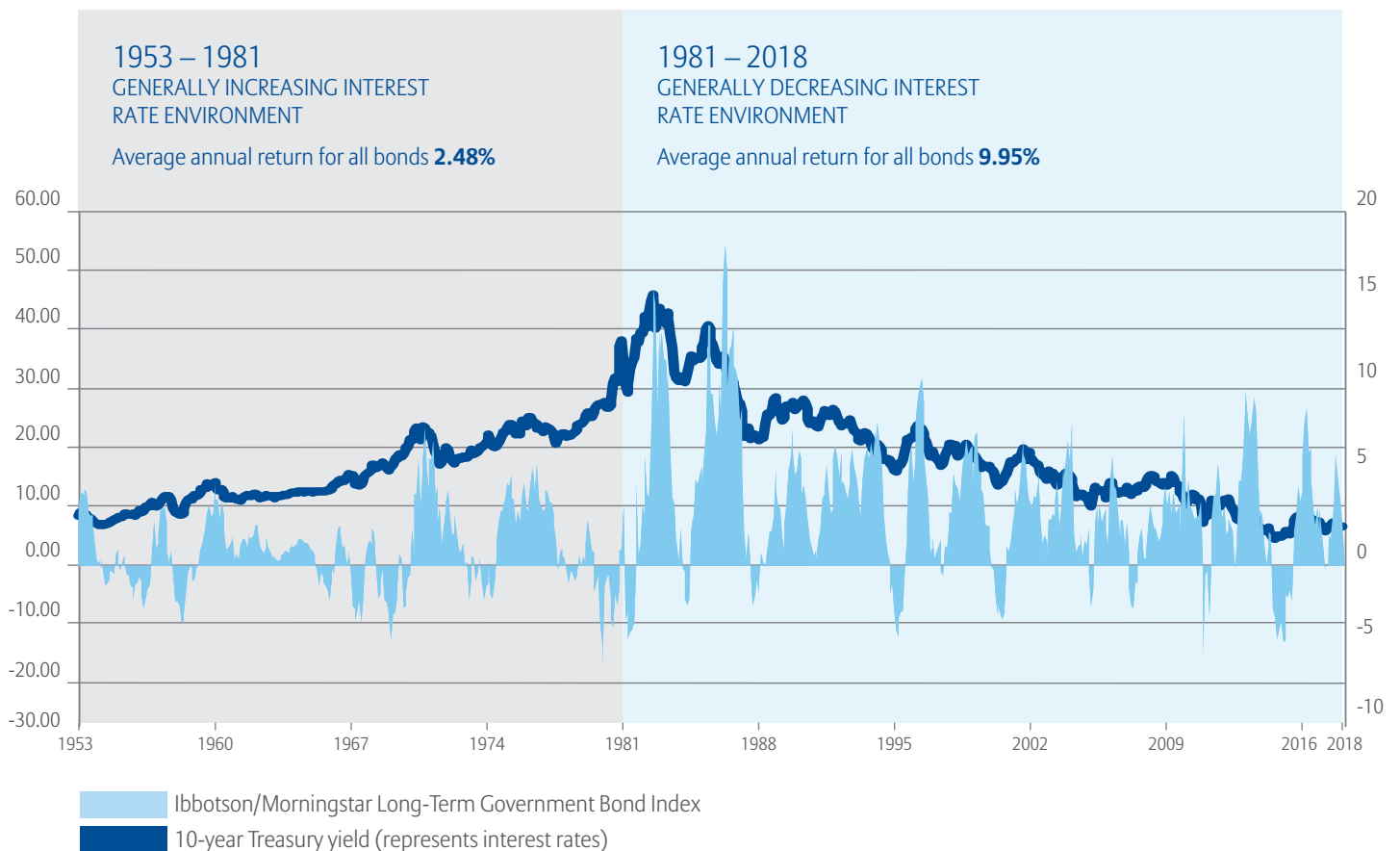
As the graph below shows, we've had more than three decades of a general trend in the baseline of declining interest rates – and with it, lower prices for newly issued bonds.

With interest rates at their lowest levels since the 1950s, the Financial Industry Regulatory Authority (FINRA) issued this alert to investors: "Many economists believe that interest rates are not likely to get much lower and will eventually rise ... then outstanding bonds, particularly those with a low interest rate, may experience significant price drops as interest rates rise

along the way." FINRA updated their alert by saying, "... just as some people's skin is more sensitive to sun than others, some bonds are more sensitive to interest rate changes than others."¹

The Wall Street Journal reported "The Fed raised its benchmark rate four times last year, most recently in December, but has recently signaled it will move to the sidelines until it can better assess how a slowdown in global growth and a sudden increase in market volatility late last year washes through the U.S. economy."²

BOND MARKET RETURNS



Source: Ibbotson/Morningstar and U.S. Department of the Treasury, 1953-2018.

With the risk of interest rates potentially rising sometime in the future, if you're holding a disproportionate amount of your assets earmarked for retirement in fixed income investments, you may have more risk in your portfolio than you realize.

¹"Duration: What an Interest Rate Hike Could Do to Your Bond Portfolio," FINRA Investors Alert, Investors Education Series, February 2013, referenced in "Understanding Bond Risk," www.finra.org/investors/understanding-bond-risk, accessed 4/10/2019.

²Nick Timiraos, "Fed Chief Jerome Powell Says U.S. Economy 'Is in a Good Place,'" *The Wall Street Journal*, updated February 28, 2019.

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The longer the term of the bond you hold, the greater the interest rate risk you are assuming.

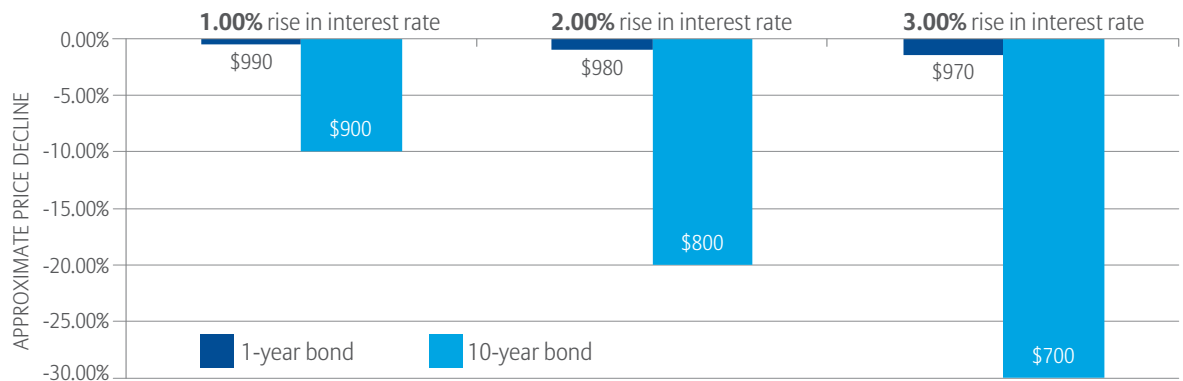
This chart illustrates that bonds with higher durations carry more interest rate risk and have higher price volatility than bonds with lower durations. This is because, in an increasing interest rate environment, shorter-duration bonds can be reinvested at new, higher rates at a quicker pace. Longer-maturity bonds tend to have longer durations. In fact, zero-coupon bonds have a duration equal to their time to maturity. Consider the following chart: A rise in interest rates of 1% would result

in a decline in price of approximately 1% in a bond with a duration of one year, a rise of 2% would result in a decline of approximately 2%, and a rise of 3% would result in a decline of approximately 3%.

Now look at how a 10-year bond is affected by the same rise in interest rates of 1%, 2%, and 3%. The 10-year bond would see a decline of approximately 10%, 20%, and 30%.

BONDS AND AN INCREASING INTEREST RATE ENVIRONMENT

LONG-TERM BONDS ARE MORE SENSITIVE to movements in interest rates than short-term bonds.



Hypothetical example using a zero-coupon bond and an initial value of \$1,000. As a general rule, for every 1% increase in interest rates, a bond's price will decrease approximately 1% for every year of duration.

If you're five to 10 years from retirement, you may not have the time to make up for any losses in your savings. And with the inflation that rising interest rates could bring, the purchasing power of your savings could be reduced as well, possibly putting additional strain on your standard of living.

Annuities may be one solution for some of your retirement assets, though some may need an additional-cost rider to help fill these needs.

Annuities can help you meet your long-term retirement goals by offering tax-deferred growth potential, a death benefit during the accumulation phase, and a guaranteed stream of income at retirement.

You should carefully consider the features, benefits, limitations, risks, and fees that may be associated with an annuity, as well as the expenses, investment risks, and objectives of the underlying investment options in a variable annuity.

Now may be a good time to consider an annuity from Allianz Life Insurance Company of North America (Allianz) or Allianz Life Insurance Company of New York (Allianz Life® of NY).

Contact your financial professional to discuss whether an annuity may be right for you.

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Charges for early withdrawals may result in a loss of contract gains or any interest (if applicable) and a loss of principal.

Any distributions from annuities are subject to ordinary income tax and, if taken prior to 59½, a 10% federal additional tax.

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While we are proud of our financial strength, we are made of much more than our balance sheet. By being true to our commitments and keeping our promises we believe we make a real difference for our clients. It's why so many people rely on Allianz and Allianz Life of NY today and count on us for tomorrow – when they need us most.

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