ROI on Treasury Inflation Protected Securities

By: www.ProfitableInvestingTips.com

As inflation raises its ugly head, investors have started to think back to the **stagflation** of the 1970s and worry about **negative real interest rates**. One option for those who want buy to US Treasures is to purchase TIPS or Treasury Inflation Protected Securities. Is the ROI on Treasury Inflation Protected Securities sufficient to stay ahead of inflation and protect you from getting negative real interest rates? And, what happens with TIPS if the economy goes into a spiral of deflation and **negative interest rates**?

What Are Treasury Inflation Protected Securities?

Also called TIPS, Treasury Inflation Protected Securities are issued by the US Treasury just like T-Bills, T-Notes, and T-Bonds. They can be purchased at **Treasury Direct**, through a bank, or through a broker. The idea behind this interest-bearing investment vehicle is to protect the buyer in the case of a huge rise in interest rates happening after the person makes their investment. The interest rate paid on a TIPS is adjusted according to the **Consumer Price Index**. Interest is paid twice a year and added to the principal. TIPS can be purchased in $100 increments for 5, 10, or 30 years. Like other Treasuries and **unlike Series I Savings Bonds** they can be bought and sold in the secondary market. TIPS can be redeemed after holding them for a minimum of 45 days.

What Is the Current Interest Rate on TIPS?

As of October 29, 2021 the interest rate for a 10 year TIPS was 2.57%. The long term effective rate will go up as the CPI rises and down as it falls. The current “break even” rate to stay up with inflation is 2%. Thus, you will not be getting a 2% yield in terms of purchasing power but your TIPS investment will currently keep up with the purchasing power it had when you purchased the 10 year TIPS. 2% is the current Fed inflation target.

What Happens to TIPS with Deflation?

The point of buying TIPS is to protect against inflation. What happens if the economy tanks and we see negative interest rates, falling prices, and a Japan-like scenario? Here is what the Treasury says about this:

> *What happens to TIPS if deflation occurs? The principal is adjusted downward, and your interest payments are less than they would be if inflation occurred or if the Consumer Price Index remained the same. You have this safeguard: at maturity, if the adjusted principal is less than the security's original principal, you are paid the original principal.*

In other words, the interest added to principal on your TIPS will be reduced as the CPI drops. But, should the bottom drop out of interest rates and the economy, the worst you can do is get your initial purchase amount back in dollars. Thus, TIPS are actually a protection against severe deflation as well as one against inflation.

Why Buy Treasury Inflation Protected Securities?

If you want part of your investment portfolio in interest bearing vehicles, US treasuries are your safest bet. The value of TIPS is that you get some protection against runaway inflation like happened in the 1970s. TIPS are not a cure all. An ETF that tracks the S&P 500 is likely to provide a better ROI over time providing that the market does not implode. The latter possibility is why many investors keep a portion of their assets in bonds, CDs, or Treasuries.

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