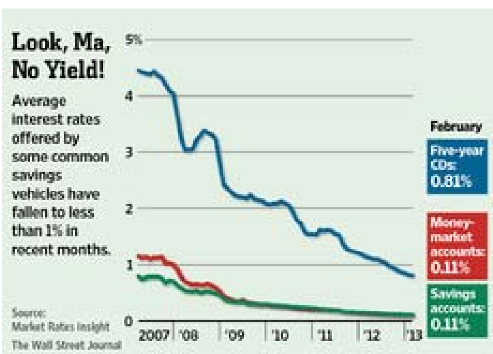
THE WALL STREET JOURNAL.
WSJ.com

WEEKEND INVESTOR | March 15, 2013, 6:44 p.m. ET

What Are CDs Good For?

By LIAM PLEVEN

Low interest rates have undercut the appeal of certificates of deposit for years. Now, some fans of the plain-vanilla savings tools are turning to them as protection against the risk that rates will suddenly rise.



The strategy: Park cash in CDs rather than buying bonds, a traditional safe haven. Sooner or later, they reason, the Federal Reserve will raise rates or bond investors will push up longer-term rates on their own. Either way, bond prices could fall, perhaps sharply, since yields and prices move in opposite directions.

Investors could avoid that hit if they choose CDs with an interest rate that isn't subject to change.

The catch is that if rates rise too sharply, investors could be locked into a savings vehicle that pays relatively little interest. Some look for CDs that allow early withdrawals with low penalties, but there are risks to that approach and experts advise depositors to read the fine print.

Nick Gieschen received a payout last year from the sale of an Internet gaming company he had worked at as a startup. In the past six months or so, he has put more than $5 million of his windfall into CDs at four different institutions.

"Instead of getting into bonds, and locked into something that's so vulnerable to inflation, I'm going with CDs," says Mr. Gieschen, 40 years old, who lives in New York. "I obviously did this to be flexible."

While weighing the move, he calculated that $1 million deposited into five-year CDs at Ally Bank, a unit of Ally Financial, would generate $14,122 in interest the first year, even after paying $2,778 in penalties—equal to 60 days of interest—if he opted for an early withdrawal. He ultimately put a smaller sum into Ally CDs.

More Weekend Investor

The Intelligent Investor: Steer Clear of a 'Custody' Battle

Allan Roth, an hourly financial planner in Colorado Springs, Colo., who advised Mr. Gieschen, describes using CDs to protect against a loss due to falling bond

Family Value: Bolstering Your Benefits
How to Safeguard Your 401(k)
Tax Report: Tax Tips for Life's Big Changes
Company Insiders Are Dumping Shares! Or Are They?
Stocks, Drugs, Rock 'n' Roll

prices as "a free insurance policy" and the early-withdrawal penalty as equivalent to paying a deductible.

Mr. Roth says his clients have warmed to the concept, amid persistent questions about how long the Fed will be able to keep interest rates low without risking higher inflation. He says he tells clients the strategy can work whether rates go up or down. Even if rates decline, clients benefit from the higher interest rate they already are collecting.

CDs are popular with some consumers because the principal is protected. Deposits also are backed by the government up to certain limits at federally insured institutions.

But many have shied away from CDs in recent years. Fed officials have suggested they still see a benefit to keeping rates low, and investors who predicted an end to the bond rally still are waiting.

The average five-year CD paid an annual percentage yield of 0.81% in February, down from 1.14% a year earlier and 4.44% in July 2007, according to Market Rates Insight, a San Anselmo, Calif.-based research firm that tracks savings products. The average three-month CD paid 0.1% in February, slightly less than the average savings account.

"Once rates in CDs started going down, it was less attractive for people to be locking down their money long term," says Dan Geller, executive vice president at Market Rates Insight. High unemployment also spurred people to keep cash in easily accessible accounts, he says.

Low interest rates trouble even longtime fans of CDs. Lisa Freedman, 58, has had money in CDs for 30 years, but has two CDs maturing this summer and is considering putting the money in more-liquid accounts.

At the same time, the Los Angeles resident knows firsthand that taking an early-withdrawal penalty can pay off. Ms. Freedman says she closed a CD early years ago, at a time when rates were rising, paid the penalty "and did very, very well" by reinvesting in a new long-term CD with a higher interest rate.

She says she will be examining interest rates and withdrawal penalties when she has to make a decision this summer.

Shopping around can be important, because the interest rates, early-withdrawal penalties and other terms can vary considerably and change at short notice.

Ken Tumin, co-founder of DepositAccounts.com, a website where consumers can compare savings products, says investors need to pay particular attention to provisions in CD agreements that spell out the financial institution's ability to increase the early-withdrawal penalty midterm or refuse early-withdrawal requests. "Those are the two risks," he says.

In addition, Mr. Tumin says, some contract provisions give CD issuers broad authority that might allow them to make such changes.

Still, Mr. Tumin says he has himself opened five-year CDs in recent months. "I definitely pay attention to early-withdrawal penalties," he says, as the ability to take money out provides "a little protection."