

“Can’t get a job in Ohio; Can’t get a table in New York”

That is how a senior government trader on Wall Street summed up the economy. I think he is right on. The current state of economic activity in the US is comprised of two parts and the parts are headed in opposite directions. Like the six blind men describing an elephant, it all depends where you stand. Wall Street and the banking industry seem to be doing fine and all economic sectors connected to the financial business are showing signs of strength. Housing in the tri-state metro area around NYC is doing all right, employment seems to be rising and municipal revenues are doing better than anticipated (read state income tax receipts). Meanwhile in the middle of the country, everything is stagnant including housing, employment and wages.

The bond investor needs to know where the economy is headed because over the longer term this will dictate interest rates hence bond prices. Interest rates are extremely low and in my opinion likely to remain so for the foreseeable future. This is based on the fact that outside of the money centers and the Washington beltway the economy of the US is still weak and without a housing sector boost will struggle along for a few years. The latest statistics on housing nationwide indicate a further deterioration in prices.

The Federal Reserve has done everything it can think of to stimulate the economy and is frankly out of weapons. The public sector is concerned with government spending on the Federal and State level and it seems highly unlikely that any addition stimulus is politically feasible. As a matter of macro economics reduced government spending will slow the economy down even further. Recently the rise in gasoline prices at the pump to \$4.00 per gallon has curtailed consumer spending in other areas. The only conclusion possible is that the economy is weak and will stay weak.

The bond investor faces a dilemma. How to invest at historically low rates, get a decent return and provide some protection against some day in the future when interest rates will again rise (i.e. bond prices will fall). The answer lies in premium bonds. Bonds are issued with a face or maturity value of \$1000. The bond also pays an interest rate times the face value. If current interest rates are 3% then a bond issued years ago with a coupon of 6% is worth more. The 6% bond will cost the investor \$1100 and when it matures the investor will receive \$1000. The extra \$100 that the investor paid for the bond will be returned to them in the form of higher semi-annual payments. Because many bond investors are reluctant to pay a premium the higher coupon bonds typically trade at a higher yield than the par bonds. When you as an investor buy a bond you invest at yield to maturity, when you are looking at bonds selling over face value compare the yield to maturity against alternative investments. Make sure you are aware of the yield to the call in case your investment is paid off early. In most cases you should find very attractive yields in premium bonds. As always talk to a bond professional who can explain all the features of the security before you invest.,