

# ASK THE ADVISERS

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## Treasury Inflation-Protected Securities (TIPS)

With inflation's recent spike, investors have been flocking into assets that can keep up with inflation, one of which has been Treasury Inflation-Protected Securities (TIPS).

TIPS are bonds designed to increase in value as consumer prices rise.

TIPS have been in existence since 1997. Since inflation has been relatively low since their creation, their popularity is only now increasing as inflation rises. But last year, as inflation shot up from 1.4% in January to 7% in December. The assets of TIPS funds have nearly doubled since 2018 to about \$295 billion.

In 2021, according to Morningstar, TIPS mutual funds beat traditional bond funds with average returns of 5.5%, compared with minus 1.7%. Unlike traditional bonds, which have a fixed face value at maturity, the face value of TIPS increases when the consumer-price index for urban consumers rises and decreases when the price index declines rather than rising at a slower rate.

TIPS will pay off at least their original face value at maturity. They pay a set interest rate, but interest payments vary because they are based on the fluctuating face value of the securities. However, TIPS often trade at a premium which means if inflation is less than expected, TIPS could underperform traditional bonds.

TIPS funds can lose value when rates rise, and bond prices go down. This just happened over the past three months as rates on 10-year Treasury notes have risen from 1.431% in early November to over 2% in early February. Over that period, TIPS funds have returned negative 2.6% on average, according to Morningstar.

In auctions since inflation kicked up, new issues have sold at premiums as high as 12.4% for the 10-year note in July of last year. In the five years before 2020, with inflation relatively low and their interest rates higher, the premiums for new 10-year TIPS never topped 1%. This means that inflation needs to remain relatively high for TIPS to beat traditional bonds. Essentially at this point TIPS purchasers are betting that inflation will continue to be higher than expected.

\*source WSJ

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