Investor Insights & Outlook

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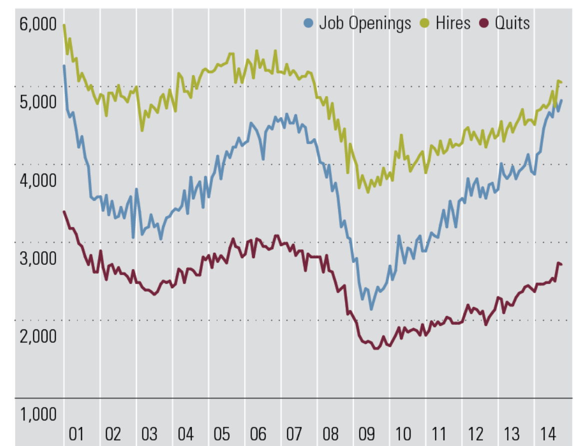
One of Yellen's Favorite Metrics 'Jolts' Ahead

The formerly unimportant job openings report has taken on a new significance since U.S. Federal Reserve Board Chair Janet Yellen has included this metric in a list of labor market reports that she is watching closely. And this relatively new report is now sending a message that we really haven't seen before. Job growth isn't much better than it has been in the past three or four years, while the number of openings per person employed is now at its best level since 2001 and way above year-ago levels.

The chart below illustrates how the growth in job openings is outpacing the growth in hires. This means that there are increasingly less workers matched with the jobs that are being posted, and it may soon force employers to increase wages in order to fulfill those unmatched job openings.

Job Openings, Quits, and Hires, Seasonally Adjusted, Thousands of Workers



This article contains certain forward-looking statements which involve known and unknown risks, uncertainties, and other factors that may cause the actual results to differ materially from any future results expressed or implied by those projected statements. Past performance does not guarantee future results.

Source: Bureau of Labor Statistics. Data through November 2014.

Advisors Corner

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Could Rising Interest Rates Hurt Your 529? (Part 1)

Bond investors have been worried about a rise in interest rates for years now, pretty much ever since the Fed lowered rates in response to the 2008–09 financial crisis. Any rise in rates hurts the value of existing bonds (on the contrary, a drop in rates helps it), and rates have been hovering near historic lows for quite a while.

For families saving for college, bonds have long been seen as a safe-haven investment—a place to park cash reserved for a specific purpose within a specific time frame and a pretty good bet to increase in value faster than cash while avoiding the volatility of stocks. But what happens when bonds themselves become riskier than they've been in the past? It's a question that many college savers, especially those who will need the money in just a few short years, are asking.

529 Plans and Duration

The majority of the $200 billion invested in 529 college-savings plans is held in so-called age-based portfolios—all-in-one investments made up of stocks, bonds, and other securities allocated based on the age of the beneficiary and, in some cases, the risk tolerance of the account holder. Typically these age-based portfolios are heavily weighted toward stocks when the beneficiary is very young, and they gradually shift assets into bonds and cash as the beneficiary gets closer to college age.

With traditional bond funds, the most commonly used method of gauging interest-rate sensitivity is a statistic called average effective duration. The higher the duration, the more sensitive the fund is to interest-rate movements. It works like this: For each percentage point that rates increase, the fund may be expected to lose in value a percentage equal to its duration in years, minus the fund's yield. For example, if rates increase 1 point, a fund with a duration of 4.5 years and a yield of 2% could be expected to lose 2.5% of its value.

Finding the Numbers for a Specific 529 Plan

Although this rule of thumb may be a convenient way of assessing the interest-rate sensitivity of a single bond fund, most 529 accounts hold multiple stock and bond funds, making it difficult to arrive at a single duration measure for the entire portfolio.

Even though your 529 plan may not provide information on the duration of your portfolio, you might be able to track it down yourself by taking a closer look at the bond funds in the plan.

Unless you have all of your 529 assets in a single bond fund, you might have to do some calculations to figure out how to weight the various duration measures. For example, if your 529 portfolio is made up of 60% equities and 40% bonds, but the bond portion is half intermediate-term bonds with a duration of 5 years and half short-term bonds with a duration of 1 year, then the bond portion of your portfolio has an average duration of 3 years.

On average, an age-based portfolio for a 15-year-old beneficiary holds about 55% of assets in bonds, according to Morningstar data, and by the time most beneficiaries are ready to enroll in college at age 18, that weighting reaches 60%. At the same time, the average allocation to cash increases even more, from about 15% at age 15 to about 30% at age 18.

Options for 529 Plan Holders

Once you have some idea of how vulnerable your 529 assets are to a rise in rates, you then can decide what, if anything, to do next. If stocks dominate your account, leaving just a small allocation to bonds, you may have little to worry about in terms of interest-rate risk. But if bonds make up the bulk of your account and you find the average duration of the portfolio makes you nervous in case rates do rise sharply, you may be contemplating some major changes.

Could Rising Interest Rates Hurt Your 529? (Part 2)

But before you do anything, consider the following for some perspective. Let's go back in time to May 2013, when interest-rate concerns also were running high because of fears that the Fed would soon begin tapering its bond-buying stimulus program. Rates climbed throughout the summer, and for the year the Barclays Aggregate Bond Index, a proxy for the U.S. investment-grade bond market, lost 2% of its value. By comparison, funds in the Age 13–18 Low Equity category actually gained 1.62% (the category includes conservatively invested age-based portfolios designed for 529 beneficiaries between the ages of 13 and 18 and currently averages a 66% allocation to bonds and a 10% allocation to stocks, according to Morningstar data). Not great, but hardly the disaster some had feared amid a rising-rate environment.

Interest rates have actually been declining in 2014, meaning that you may have been better off holding intermediate- and long-term bonds than stocks. Of course, rates could very well go up in the coming year, and 529 account holders with heavy allocations to bonds could see losses. But the larger point is that interest rates don't move in a straight line, and predicting their near-term direction (and thus their effect on bond prices) can be just as difficult as predicting that of stocks.

However, if you still wish to reduce the interest-rate risk of your 529 holdings, there are steps you can take. One would be to move the bond portion of your portfolio to a short-term bond option, if your plan offers one (short-term bonds are more immune to interest-rate movements than longer-term bonds), or perhaps to cash. If you've been using an age-based portfolio, this might require you to move assets out of it and create your own customized allocation using the plan's pure-stock-fund and pure-cash-fund offerings. But that might be the only way you can completely remove bonds from the equation.

Keep Calm and Carry On

Although there's no imminent reason to worry about a rise in interest rates wreaking havoc on the bond portion of your 529 portfolio, investors with heavy allocations to bonds still would be well-served in taking a peek under the hood just to see what's there in terms of interest-rate sensitivity. If what you find makes you uncomfortable, consider the aforementioned actions of reconfiguring your portfolio. If not, at least now you know what to expect if and when rates do rise.

529 plans are tax-deferred college savings vehicles. Any unqualified distribution of earnings will be subject to ordinary income tax and subject to a 10% federal penalty tax. Tax law is ever-changing and can be quite complex. It is highly recommended that you consult with a financial or tax professional with any tax-related questions or concerns. An investor should consider the investment objectives, risks, and charges and expenses associated with municipal fund securities before investing. More information about municipal fund securities is available in the issuer's official statement, and the official statement should be read carefully before investing.

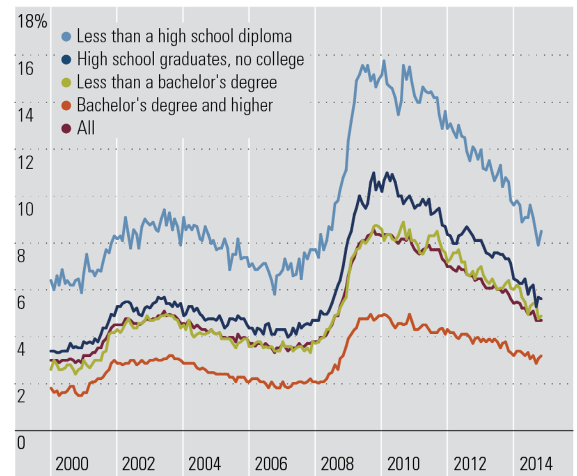
Indexes are unmanaged and not available for direct investment. Past performance does not guarantee future results. Investments in securities are subject to investment risk, including possible loss of principal. Prices of securities may fluctuate from time to time and may even become valueless.

Unemployment by Education Level

There is a clear connection between educational attainment and unemployment rate. As expected, the people with the highest rate of unemployment are the people without even a high school degree. The unemployment rate for this group is almost triple that of college graduates. In general, the more education you have, the better off you are.

The percentage of the population that has a college degree has been relatively stable in the 30% range. And there is a large part of the population that could probably use yet more college education. Putting these two together, the conclusion is evident: It pays to go to college, and it would also be good if the percentage of the population who are college graduates could increase.

Unemployment Rate, 25 Years and Older



Source: Bureau of Labor Statistics, Morningstar calculations.
Data as of November 2014.

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