

Your *Trust* Matters

May 2023 Newsletter



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TRUST SERVICES



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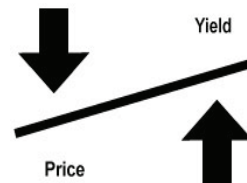
Increasing Fixed Income Duration: Capturing Opportunities in Falling Interest Rate Environments

Fixed income investments can play a crucial role in a well-diversified investment portfolio. When investors anticipate a decline in market interest rates, which is widely expected in the coming years, increasing fixed income duration is a strategic move with a number of potential advantages. The duration of a fixed income investment indicates the price sensitivity of a fixed income investment relative to a corresponding change in interest rates.

In 2022, as rates rose, bond prices fell accordingly. Since March 2022 the Federal Reserve has increased the Federal Funds Rate nine times in a quest to tame inflation. Market participants widely believe that we are now at, or close to, the highest rates for this tightening cycle (a.k.a. “peak rates”) and that the next rate moves will hold steady and eventually lower.

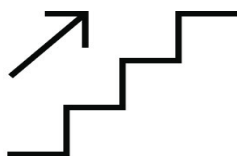
Capital Appreciation

When interest rates decline, the value of existing fixed income securities tends to rise. By increasing fixed income duration, investors can take advantage of the inverse relationship between interest rates and bond prices. Longer-duration bonds are more sensitive to changes in interest rates, resulting in greater potential for capital appreciation. As rates fall, the prices of longer-duration bonds increase more significantly than shorter-duration bonds, allowing investors to capture gains in a falling interest rate environment.



Enhanced Yield

Increasing fixed income duration can also lead to higher yields for investors. When interest rates decline, newly issued bonds offer lower coupon rates. By extending duration and holding existing bonds with higher coupon rates, investors can lock in more attractive yields compared to the lower rates available in the market. This enhanced yield provides a stable income stream which can be especially valuable for income-focused investors, retirees, or others seeking to generate steady cash flow from their investments.



continued on page 2

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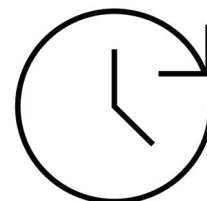
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Portfolio Risk Management

Fixed income duration acts as a risk management tool within an investment portfolio. In a falling interest rate environment, increasing fixed income duration can help mitigate interest rate risk. When interest rates decline, the potential for capital appreciation in longer-duration bonds offsets potential losses in other asset classes that are negatively impacted by falling rates. This helps balance the overall risk profile of the portfolio and provides a hedge against potential market volatility.

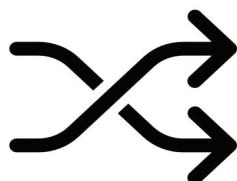
Duration Matching

Investors with specific future cash flow needs can benefit from increasing fixed income duration. For example, if an investor anticipates upcoming liabilities or financial events in a low-interest rate environment, extending duration can align the timing of bond maturities with those future cash flow requirements. By matching the maturity of fixed income investments with specific liabilities or goals, investors can better ensure the availability of funds when needed while potentially capturing the benefits of falling interest rates.



Diversification and Stability

Increasing fixed income duration can enhance diversification within a portfolio. When combined with other asset classes such as equities, real estate, or alternative investments, fixed income investments with longer durations offer a counterbalance to the potential volatility of other higher-risk assets. This diversification helps stabilize the overall portfolio and reduces its sensitivity to short-term market fluctuations, providing a smoother investment experience.



Please don't hesitate to contact your MidWestOne Bank advisor to see how falling interest rates could impact your portfolio and comprehensive wealth plan.

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