

# Market-Linked CDs

*These investments may yield more for you than the typical fixed rate of return.*

Provided by Edward Grondahl

**You say you're a conservative investor who wants more yield?** Then you may want to consider market-linked CDs – certificates of deposit linked to the performance of a market index.

With yields on fixed-rate CDs so low right now, investors are turning to these indexed CDs because of their potential for comparatively greater returns.

**These CDs credit you with a “participation rate” in return for your investment.** For example, if the associated index rises 12% in a year and your participation rate is 50%, you get a 6% return. (That certainly beats a 1% return.) The linked index might be the S&P 500, the Dow Jones Industrial Average, a tech index, a global index – it varies per CD.<sup>1</sup>

**A market-linked CD is usually a short-term investment.** Most of these CDs have maturity dates of 3-5 years. The deposits typically range from \$1,000-\$20,000. You are guaranteed not to lose your principal if you hold the CD to maturity, for the Federal Deposit Insurance Corporation insures these investment vehicles.<sup>1</sup>

**Indexed CDs do have some downsides.** The interest on them is only paid when they mature, and before maturity, the CD might produce “phantom income” – that is, taxable interest you must report to the IRS. (These are not tax-deferred investments.) Some of these CDs are “callable” – if interest rates fall, the issuer has the option to execute a call and terminate the CD, paying you back your principal and accrued interest.<sup>1,2</sup>

If you decide to take money out of a market-linked CD before the end of its term, you will probably pay for that decision. You will likely be hit with a penalty as you redeem your principal. Some indexed CD contracts allow you to sell your CD before it matures, if you like – but if the linked index has performed poorly, there is the chance that you could sell at a loss since the value of the CD depends strongly on the performance of that index. These CDs can also be illiquid during their first year.<sup>1,2</sup>

**That said, there is much to like about these CDs.** They offer you the principal protection guarantee of a standard certificate of deposit, plus the chance for notably better yield than a fixed-rate CD. You just have to recognize the necessity of holding the CD until maturity.

**Ed Grondahl may be reached at 218-878-3922 or [Edward.Grondahl@cunamutual.com](mailto:Edward.Grondahl@cunamutual.com)**

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#### Citations.

1 - investopedia.com/articles/bonds/09/equity-index-cds.asp [8/25/16]

2 - finance.zacks.com/disadvantages-structured-cd-investment-11399.html [8/25/16]