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# Should You Buy a Variable Rate CD?

If rates continue to rise, so will your CD's APY. But if the Fed starts to cut rates, you could lose out.

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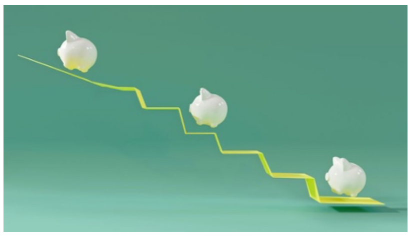
*By Martha C. White*



Certificates of deposit usually offer a straightforward deal. Agree to lock up your money for a fixed term, say six months or a year, and during that time you'll receive a fixed rate of interest.

But during periods of rising interest rates—like right now—that deal can feel risky for some investors. Their thinking is: If you lock in today's rates, then rates continue to climb in the future, you could miss out.

Some banks have responded by offering variable rate CDs, with interest rates that rise and fall with market conditions. These products typically come with slightly higher starting interest rates than comparable traditional CDs. And if rates continue to climb, you could earn even more.

But, say experts, there are risks, too. Rates on variable CDs can go down as well as up. While the Federal Reserve has been steadily raising rates for the past year, the pace of those increases has been slowing.

The upshot: While floating rate CDs can seem appealing at first glance, given today's interest rate environment, most financial planners recommend sticking with traditional options. "My personal opinion is rates are at or near the top," says Joseph Heider, president of Cleveland-area wealth management firm Cirrus Wealth Management.

## What to know about variable rate CDs

The number of banks and credit unions offering variable rate CDs is small but growing.

Merchants Bank of Indiana offers one-, two- and three-year floating rate CDs that start at 5.39% APY. Workers Credit Union has variable CDs in six-month as well as one-, two- and three-year maturities with a top APY of 5.39% (rates vary depending on what length you pick).

Some institutions just offer a single variable CD option: Valley National Bank offers a three-year variable rate CD with a current APY of 5.1%, and Hudson Valley Credit Union has a one-year certificate with a 5.06% APY.

The banks and credit unions that offer floating-rate CDs may call them "flex," "flex index" or just variable CDs. Although the names can vary, they're easy to spot because their APYs are higher—typically by about half a percentage point—than what you would earn with a fixed-rate CD of comparable length at that same bank.

Like other CDs, floating rate CDs require you to commit your money for a set term. If you need to withdraw earlier, you may owe penalties.

Instead of a fixed rate of interest, the amount floating-rate CDs pay is tied to the benchmark federal-funds rate set by the Federal Reserve, or a closely correlated number such as the prime rate or short-term Treasury yield, plus or minus a fixed margin.

Some banks will set a minimum or maximum that the rate could rise or fall, but not all do. In addition, some banks adjust rates on a regular schedule, such as monthly; others change as often as the underlying rate does.

**Pros and cons of variable rate CDs**

With today's high interest rates, a CD that lets you squeeze a little extra yield out of your money might seem like a smart move. And if rates continue to rise, a variable-rate CD would keep up with those increases instead of tying up your cash at a lower rate of return.

Since rising interest rates sometimes correlate—as they do currently—with elevated inflation, a rate that rises in tandem with a benchmark rate can help preserve the purchasing power of that cash.

Still, many experts warn the risks could be greater than the benefits. One big reason: While the Fed has spent the last year steadily raising interest rates to fight rising prices, inflation seems to be coming under control, while other considerations like the risk of a recession are growing. In fact, most experts see CD rates going lower by the end of 2023, not higher.

"I'm not a big fan of variable-rate CDs at this point in the tightening cycle," warns George Kiraly Jr., founder and chief investment officer of LodeStar Advisory Group, a Naples, Fla.-based financial planning firm.

What to buy instead? There are plenty of ordinary CDs on the market today with APYs north of 5%, advisors point out. You could lock in a rate not too much lower than a floating-rate CD and know that your earnings will stay the same no matter what the economy does.