UBS PaineWebber
Municipal Securities Group
Municipal Insight

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The Cost of Waiting

Will yields go up or down?
Should I invest now or later?

How should an investor decide whether to invest at market yields or to defer the investment for a later date? While interest rates are impossible to predict, it is possible to estimate the risks and rewards of acting or waiting. Compare two investors:

- **Investor "A"** makes an investment today, purchasing 100M insured non-callable bonds due in ten years at a yield of 3.75% and priced at par.
- **Investor "B"** wants to wait to get 4.25% on his money, so he decides to leave his money in a tax-exempt money market fund (currently at 0.42%) and he waits 12 months before investing.

By deciding to accept the lower yield in the first year and hoping for a higher yield in twelve months, how long might it take for Investor "B" to break even on the cumulative income he hopes to earn? *(For simplicity, these comparisons assume that all investments are made at par and that tax-exempt money market rates remain stable for the entire twelve-month period.)*

	Investor "A"	Investor "B" *Scenario 1*	Investor "B" *Scenario 2*	Investor "B" *Scenario 3*	Investor "B" *Scenario 4*
	Invests Now	**Waits: Rates Drop**	**Waits: Rates Remain The Same**	**Waits: Rates Move Higher**	**Waits: Rates Hit the Investor's Target**
	Buys 3.75% insured tax-free municipal bond due in 10-years.	1 year at 0.42%, then 3.5% for the balance of the 10-year period.	1 year at 0.42%, then 3.75% for the balance of the 10-year period.	1 year at 0.42%, then 4% for the balance of the 10-year period.	1 year at 0.42%, then 4.25% for the balance of the 10-year period.
End of:	**Cumulative Income**	**Cumulative Income**	**Cumulative Income**	**Cumulative Income**	**Cumulative Income**
Year 1	$3,750	$420	$420	$420	$420
Year 5	$18,750	$14,420	$15,420	$16,420	$17,420
Year 10	$37,500	$31,920	$34,170	$36,420	$38,670

- **If Rates Drop** (Scenario 1), the break-even date moves further out or becomes unreachable during the horizon period.
- **If Rates Remain the Same** (Scenario 2), Investor "B" would not be able to replace the income he gave up in year one.
- **An Increase in Rates** would favor Investor "B", but only if he is able to invest his money for the remaining nine years of the holding period at a yield of 4.12% or higher. Scenario 3 demonstrates that an increase in rates to 3.75% would produce lower cumulative earnings than investing now, assuming stable money-market fund earnings. A yield lower than 4.12% would not generate enough cumulative cash flow to offset the lower earnings in year 1. (Scenario 4 does not break even until the eighth year of the holding period.)

This discussion does not account for investors who reinvest their interest earnings and would therefore be earning interest on their interest. While it is impossible to know YOUR cost of waiting except in retrospect, you can see it is possible to estimate your potential risk/reward for investing now or later. The decision to invest now or later—like all investment decisions—depends on each investor's individual situation. For additional information, please contact your UBS PaineWebber Financial Advisor.

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