Why Should I Open a CD Instead of Buying U.S. Bonds?

Certificates of deposit and U.S. bonds are similar types of investments. CDs are insured by the FDIC, while bonds are issued by the federal government, so both offer low-risk options for people who want a safe place to park their money. However, this lack of risk translates into a decrease in the profit you make from an investment, also known as the yield. Although certificates of deposit and U.S. bonds are comparable, there are some aspects of CDs that make them more desirable than bonds for many investors.

Time to Maturity

There can be vast differences in the time it takes for certificates of deposit and U.S. bonds to reach the date at which the funds stop accruing interest and are available for withdrawal or redemption. Financial institutions commonly offer three and six month CDs, as well as one- to five-year terms. CDs with longer maturity terms have higher interest rates and, subsequently, increased yields. U.S. bonds, on the other hand, have a maturity term of 10 to 30 years, depending on the type of bond.

Short-term Vs. Long-term Investment

While a bond with a 30-year maturity term can certainly lead to higher yields than a 3-month CD, a problem for many people is that you have to keep the bond for the full 30 years to gain the total possible return. Although bonds are redeemable before the maturity date, you will lose out on the full interest, decreasing your potential yield. CDs allow for short-term investment but also provide you with the option to roll mature certificate of deposit funds over into a new CD and continue investing as long as you want.

Interest Rates

Certificate of deposit interest rates are determined by the bank offering the CD. This is usually a few points above the current prime rate, but banks often offer higher, more competitive rates on CDs to attract customers. Bond rates, however, are set by the U.S. Treasury every six months and are not subject to competitive increases.

In addition, CD rates are usually fixed for the entire term, although some banks do offer variable-rate CDs. Fixed rates can be especially beneficial for short-term CDs because you can reinvest mature certificates when interest rates are high or move your money to another bank if you find a better rate elsewhere. U.S. bonds have a fixed rate that is set by the Treasury at the time of purchase and remains in effect for the entire 10- to 30-year term. If the interest is low when you purchase the bond, you will be stuck with that rate for many years unless you redeem the bond early.

The Verdict

Ultimately, the choice between CDs and U.S. savings bonds comes down to what you’re looking for in an investment. Despite the similarities between the two, the differences in maturity and investment terms, as well as interest rates, make CDs a wise choice for people who want reliable, short-term investments.