



Today's Hottest Investment? Bank CDs

Rising rates, recent bank failures, and a tepid stock market are making a lot of people reconsider CDs as a viable investment alternative.

Many banks now offer rates over 5% for a one-year CD, up from under 1% a year earlier.

What a difference a year makes. Suddenly, people are piling into bank certificates of deposit (CDs). With rates under 1% for most of the past decade, CDs have long been considered more of a cash holding tank than a viable investment. But today, many banks are offering CDs with rates over 5% -- their highest rate in over 20 years -- making them an attractive investment alternative.

Why the change? Most of the credit goes to the Federal Reserve, which has raised the federal funds rate (to which CD rates are tied) 10 times in the past 15 months. The recent interest in CDs also reflects a flight to quality -- or to FDIC-insured accounts at least -- in the wake of several large bank failures in recent months. A sluggish stock market is also driving many investors elsewhere.

Here are some questions you'll want answers to before you join the crowd.

Are CDs FDIC insured?

CDs are insured by the FDIC up to \$250,000 per depositor, per bank, and per ownership category. This makes them a relatively low-risk investment option. The interest rates are guaranteed for the term of the CD and are not subject to market fluctuations.

Is there a penalty for early withdrawal?

Once you open a CD, you generally cannot withdraw your money until the end of the term without paying a penalty. Some CDs offer the option to withdraw interest payments without penalty, but this varies by financial institution.

How do CDs compare with savings or money market accounts?

Rates on CDs are generally higher than on money market and savings accounts because you are required to lock your money in for a period of time. They also have a higher minimum balance. The interest rate on a CD is also fixed for the term, while rates on savings and money market accounts may vary.

How is CD interest taxed?

Interest from a CD is taxed as ordinary income on the federal level and may also be

subject to state and local taxes. You typically pay taxes on a CD in the year you earn the interest. It doesn't matter if your CD hasn't matured yet. Taxes are still due in the year interest posts to your account.

Who do CDs make most sense for?

CDs are a good option for individuals who have idle money sitting in a checking account earning next to nothing or who are saving for a specific goal -- such as a down payment on a home or a new car -- but do not need the money until a later date. They are also a popular choice for retirees looking for a relatively safe investment that provides a predictable source of income. Because CDs offer a fixed interest rate and a guaranteed return of principal, they are considered a low-risk investment that can help retirees meet their income needs.

But CDs aren't right for everyone. Even at today's rates, they may offer a lower rate of return when compared to other investment options like stocks or mutual funds, especially over longer periods of time. Plus, CDs require that you commit to a fixed term, which can be a disadvantage if you need access to your money before the term ends.

If you're thinking that a CD might make sense for you, be sure to shop around for rates, which vary from bank to bank, and also depend on how much and how long you invest. Online banks tend to pay the highest rates but not always. A financial professional can help you find the best rates and terms for your situation.