How to ladder a CD portfolio

By Laura Bruce • Bankrate.com

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Laddering a CD portfolio is a lot like dollar-cost averaging when you buy stocks. You don't invest all your CD money at one low rate of return.

You also are never more than a year away from at least some of your money.

Here's how laddering CDs works:

You go to the bank with $25,000 and buy a $5,000 one-year CD, a $5,000 two-year CD and so on until your last $5,000 buys you a five-year CD. Each year is a rung on the ladder. When the one-year CD matures, you reinvest that money in a five-year CD because by that time your five-year CD has four years left until it matures. As each year's CD comes due, you roll it into a five-year CD.

Jason Flurry of Planmark Capital Management in Alpharetta, Ga., has put together an example of how laddering is better than putting all your money into one particular maturity.

"The laddered CD program helps give you more liquidity while offering a more stable source of income," says Flurry. "Consider what would have happened to two hypothetical investors who invested $50,000."

Investor A bought a $50,000 one-year CD and reinvested in one-year CDs every year thereafter at the following rates:

Investor A -- Reinvesting plan	
Year	**Rate**
Intial purchase	5.85%
End of year 1	6.10%
End of year 2	5.60%
End of year 3	5.05%
End of year 4	6.50%
End of year 5	4.00%

Investor B bought $10,000 each of a one-, two-, three-, four- and five-year CD in May 1998 and then bought $10,000 each of a five-year CD as each CD matured. The CD rates were as follows:

Investor B -- Laddered portfolio	
Initial Investment	**Buy when initial CD matures**
1 year @ 5.85%	5 years @ 7.10%
2 years @ 6.40%	5 years @ 6.20%
3 years @ 6.70%	5 years @ 5.95%
4 years @ 6.90%	5 years @ 7.20%
5 years @ 7.10%	5 years @ 5.45%

Let's compare the annual income stream generated from these two strategies.

Income comparison: Reinvesting vs. laddered portfolio							
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**This year**	**Total income**
Investor A	$2,925	$3,050	$2,800	$2,525	$3,250	$2,000	**$16,550**
Investor B	$3,295	$3,420	$3,400	$3,190	$3,325	$3.355	**$19,985**

"The laddered-CD plan (Investor B) returned $3,435 more interest income during the six-year period," says Flurry. "The plan also provided a steadier stream of income. Investor A's income fluctuated as much as $1,250 between the best and worst years, whereas Investor B's income only fluctuated as much as $230. In a normal yield curve, longer-term maturities will typically have higher yields than shorter-term maturities."

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