

How Long Should You Lock Up Your Money in a CD?

A CD, or Certificate of Deposit can be set up to remain active for virtually any period of time, but the most popular lengths of investment are three months, six months, a year or three years. Each term length has its own merits, but as a general trend, the longer the term, the higher the interest rate will be. It is important, however, to review all options and details about the CD in question before haphazardly throwing your money into whichever one has the highest yield.

Many CD investment plans have contingencies and exceptions to go along that the broker may not be forthright in mentioning to individuals who do not ask. Before deciding how long to tie up money in a Certificate of Deposit, one should do their own research, compare options from different financial institutions and read all of the fine print.

Due to the unpredictable rise and fall of interest rates over a period of time, many smart investors have begun to spread their money across several contracts. While a longer term CD may seem the best option at the time of purchase, due to the higher interest rate, one cannot easily predict the likelihood that this fact will change down the road.

A problem many people find with long term CDs is that, should the interest rate suddenly skyrocket a few months into the term, their rate is still fixed at the amount they bought it at and they regret not securing a shorter contract. And to withdraw funds from a Certificate of Deposit before the end of the term typically requires a significant early withdrawal fee.

Investors have found a great way, however, to make the most of the ever-changing interest rates, without feeling as if they are making any investment too risky or too conservative. The method is called laddering and it entails the purchase of several CDs at once, each with varying term lengths.

To ladder one's CD investments, an individual simply purchases each one to expire equidistance in time later than the previous one, so that, as the name implies, the investment cycle can be visualized like the rungs of a ladder. For instance, one might buy five CDs, with one expiring in five years, one in four, one in three, one in two and the other in a one year term. The idea is to invest the same amount of money in each CD contract, so that one CD is constantly maturing. Once it matures, you can reinvest, if it seems profitable, in another CD of the same length, thereby ensuring that you have the chance to take advantage of a potentially higher interest rate.