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While I've spoken many times about this issue, one of the most significant news items (at least in the financial world) has to be the dramatic increase in long-term interest rates we've seen so far in 2013.

I think we are all now aware that rates are going up. The 2.99% 5-year mortgage rate now seems to be history and (I'm sure) the days of actually being paid a little interest on our savings and chequing accounts is just around the corner.

But I think the current rise in interest rates is a lot more significant than "what am I earning on my GICs or paying for my mortgage". The dramatic reversal in rates will likely have profound implications in the way investors view their portfolios and the "risk versus return" issue.

Six months ago, 10-year U.S. Treasury bonds (a good proxy for long-term rates) were yielding 1.60%. Today, they are pushing 3%. The rise has been so significant that it's created one of those weird periods in the markets where it seems the more conservative the investment, the worse it's doing. And I don't believe that's sunk in for many investors.

A quick glance at some long-term government bond and Exchange Traded Funds shows that some are down by 10% to 15% so far in 2013. Let me ask you this: If your investment is yielding 2% and it's just lost 12% in value, how long will it take you to recoup? A long time. And that's assuming rates don't go any higher. A similar story is playing out with other longer-term income investments.

I suspect this will catch a lot of conservative investors by surprise. And it's not just the recognition that a guaranteed or "safe" investment can actually lose money in a given year. I think the big issue is that the EXTRAordinary returns that a lot of conservative investors have come to expect over the past decade or more have now, in all likelihood, gone for good.

That's because as rates fell from double-digits to below 2%, virtually anything with a yield appreciated in value. Bond funds, REITS, income trusts, utility stocks – often experienced total annual returns (income + capital appreciation) of over 10% as rates fell. Why bother to include riskier assets in a portfolio when a more conservative mix is delivering these sorts of returns?

If those days are gone, then a 3% bond is going to return 3% at best - and if an investor wants (or needs) more, they're not necessarily going to get it by throwing some REITs or utility stocks into the mix. Higher returns are going to require adding higher-risk securities – and keeping risk down is going to require a little more thought. Fortunately, there's a solution, and it's something I've also talked about a lot over the years – it's called diversification.

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