Why You Shouldn't Overlook GICs As An Investment Choice

Tim Wilson

Over the past few weeks, the volatility in the global stock markets has reinforced the importance of maintaining a balanced investment portfolio. In particular, the turbulence in the equity markets should be causing investors to take another look at their fixed income allocations.

Among the fixed income investment options, Guaranteed Investment Certificates (GICs) are often overlooked. There is $503 billion in demand for GICs in Canada right now, but in recent years investors and their advisors haven't given GICs as much love as they did in the 90s when they were yielding as much as five or six percentage points above inflation.

Like all investing the right solution is most often about timing and this is the time to cozy up to GICs. Right now, GIC yields are about 1% higher than government bond yields – and this gap is considerably wider than it was just two years ago. On a $25,000 investment, that's $1,300 of extra interest over a five year period. Put another way, you would earn 1.6 times the amount of interest with a GIC than you would earn on the government bond.

Often hidden in the shadows of other fixed income investment options, GICs offer unique benefits and can play an integral role in your investment plan. These benefits include:

1) A guaranteed return of principal - Regardless of how you choose to invest, at the end of the term, you will receive back the full amount that you invested.
2) Government guaranteed - the issuers of GICs are all stable institutions regulated by the Federal Government. In the highly unlikely event that the issuer of your particular investment was to ever run into trouble, you also have the government as a backstop. GICs from Canadian Deposit Insurance Corporation (CDIC) member firms fall under the government's CDIC program and are protected up to $100,000.
3) Predictable and stable income - GICs coupon payments are fixed for the term of the investment, and as such don't fluctuate in price every time interest rates change. Your rate of return is fixed.
4) Flexible investment options – GICs come in a range of terms, from 30 days to five years. They may also offer a choice of interest payment frequencies.
5) Eligible for Registered Accounts - Not only do they provide stability and security, they can provide those same benefits within tax-sheltered plans such as RESPs, RRSPs, and TFSAs. This flexibility makes them a suitable product for people with a range of financial goals at any stage in life.

The Returns

If you compare the returns that GICs deliver to the returns you get with other common fixed income choices, GICs significantly outperform. So how much more can you save with a GIC over other alternatives? Well consider this: if you invested $100 three years ago in GICs and two other common fixed income vehicles, the chart opposite shows what your principal would look like today.

Laddering GICs

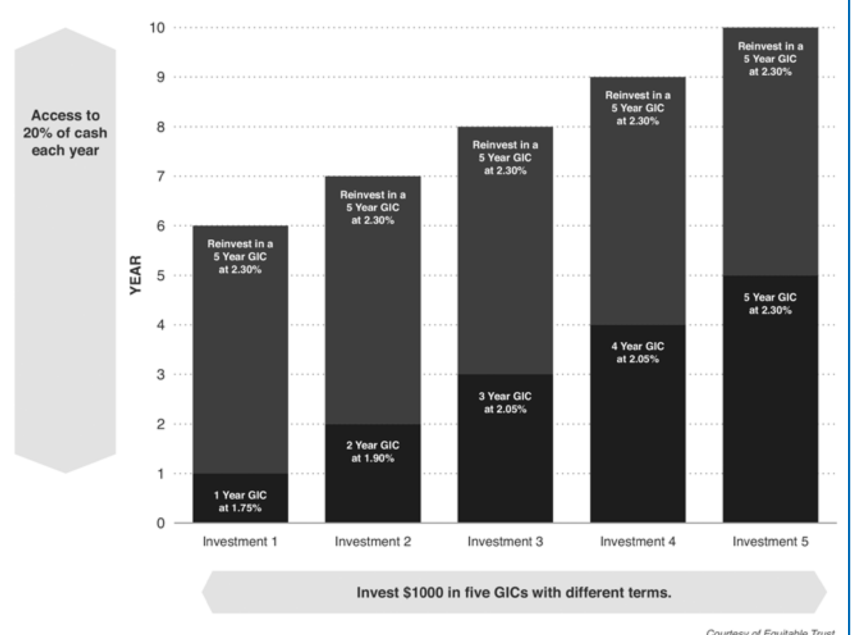
If frequent access to your cash is important to you, you can use a GIC laddering strategy. A laddering strategy entails staggering the maturity dates of your investments so that a portion of your portfolio matures each year – or

$100 Investment	Investment Value Today	Annualized Return
GIC	$107.90	2.57%
Government Bond	$105.80	1.90%
Canadian Money Market Fund (average of top 5)	$101.54	0.51%

more frequently. This allows a portion of the investment to be available each year for people who may want access to cash. If you don't need the cash when a given GIC matures, you can simply reinvest it in another GIC. This strategy can be pursued with as little as $5,000.

How To Create A GIC Ladder:

- Purchase five GICs in equal amounts staggered to mature at one, two, three, four and five years.
- When the first GIC matures at the end of year one, renew it for a five year term. When all the subsequent GIC terms mature, renew them for five year terms to maintain the effectiveness of the ladder.



Courtesy of Equitable Trust.

By staggering the original maturity dates using a mix of terms, you can reinvest the maturating principal exclusively in five year GICs and still have cash accessible each year. Five year GICs provide the highest rates and allow you to maximize your returns.

Are GICs Right For Everyone?

GICs aren't just for our grandparents. Often, younger and middle-age people erroneously discount this product category in their financial savings mix because they identify them as a safe, secure retirement vehicle. The reality is, there are good arguments to be made as to why GICs can be beneficial at any age. Whether it be new parents saving for their child's education through an RESP or a newlywed couple starting their life together by buying GICs to put into a TFSA, GICs can provide benefits at various different life stages.

Before choosing which investment vehicle is right for you, it is important to weigh your investment options and identify your own risk tolerances. Regardless how much risk you want to take, investment strategists recommend that you have a portion of your investment portfolio in fixed income – and due to their low risk and good returns, GICs are a great fixed income option.

Shopping Around

Would you ever buy a new car by visiting a dealer, and take the first option and the first price that they put in front of you? Probably not. You would look around and review different options, just like you would for any other product that you buy. Likewise, it's important to shop around for GICs to make sure that you are getting the best deal. The product is relatively standard but rates can vary, so do your homework.

The good news is that GICs are a very competitive market. GICs are available at your bank branch, online, or at your discount brokerage. There are also independent brokers that sell GICs across the country. There are also several online tools available that allow you to shop around.

Regardless of past perceptions of GICs, now is the time to put those aside and focus on the benefits and the returns that this low risk investment provides. Particularly during times of unrest in the markets, GICs can bring some much needed security and growth to any investment portfolio.

Tim Wilson is Vice-President and Chief Financial Officer at Equitable Bank He has spent more than 15 years in the investment and finance industry. Previously he held the posi-tion of president of Visa Canada and had a senior executive position with CIBC. He is a CPA, CA, and also holds an MBA from Harvard Business School.