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Why GICs beat bonds for your fixed-income portfolio

By JOHN HEINZL
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What is your opinion of GICs? Is now a good time to buy them?

If you're looking for a dead simple solution for the fixed income portion of your portfolio, guaranteed investment certificates have a lot going for them.

For starters, they're easy to understand: You invest a chunk of money, agree to lock it in for a certain period and earn a defined annual interest rate. If you choose a compound GIC, your interest payments will be reinvested automatically - another plus.

Bonds, on the other hand, fluctuate in price because they trade on the secondary market.

And bond-interest payments generally aren't reinvested automatically, so you lose the benefit of compounding.

GICs and government bonds are both safe. Bonds are backed by the credit of the government and GICs are usually guaranteed by a federal or provincial deposit-insurance program (check with the insurer or guarantor for any limits that might apply).

But GICs typically pay higher interest rates than government bonds of the same term. The five year Government of Canada bond currently yields about 2.1 per cent, for example, compared with more than 3 per cent for a five-year GIC at financial institutions such as Meridian Credit Union, EQ Bank and Oaken Financial.

The main reason for the difference in yields is liquidity. You can sell a bond at any time if you need the money. But, unless you hold a cashable GIC, you generally can't sell it before maturity because there is no active secondary market. The trade-off for locking in your money is that you get a higher yield from a GIC.

GIC yields have been rising recently, making them even more appealing. A one-year GIC at Tangerine Bank, for instance, now pays 2.3 per cent, up from 1.3 per cent in February, 2017. Tangerine's five-year rate of 3 per cent has also gained a full percentage point over the same period.

Rates at other institutions have risen by similar amounts.

If you're thinking about purchasing GICs, be sure to shop around as rates vary widely, with smaller financial institutions typically offering higher rates than the big banks. Websites such as ratehub.ca, ratesupermarket.ca and highinterestsavings.ca make it easy to compare GIC offerings.

To control your interest-rate risk, consider building a "ladder" of maturities, with equal amounts invested in one-, two-, three-, four- and five-year GICs.

When the one-year GIC matures 12 months from now, use the proceeds to buy a new five-year GIC.

A year later, roll the maturing two-year GIC into another new five-year GIC, and so on.

Laddering has several advantages. It gives you access to a portion of your cash every year if you need it. It prevents a situation where all of your investments come due during a period of low interest rates. And it ensures that you'll always be reinvesting your money into a new five-year GIC that offers the highest rates.

You don't necessarily have to extend the ladder out a full five years. A three- or four-year ladder is fine and might even be preferable in a rising-rate environment because your money will mature sooner, allowing you to reinvest it at higher yields.

As much as I like GICs for their simplicity and safety, I believe most investors should still have exposure to stocks, either directly or through low-cost mutual funds or exchange-traded funds.

GICs can't compete with the long-term returns of stocks, but devoting a portion of your portfolio to GICs will help you sleep better when the market hits a rough patch. That peace of mind is worth a lot - particularly if it helps you stay committed to your long-term investing plan.

Do you believe in the "sell in May and go away" strategy?

No. I believe in buying and holding great companies and collecting their dividends all year round. Some studies purport to show that the six months from May through October have produced weaker returns than the period from November through April, but I've never seen a convincing explanation as to why it would be anything more than a statistical quirk. Besides, the strategy backfires a lot of the time: In 2017, for instance, the S&P/TSX Composite Index posted a total return of 4.3 per cent from May 1 through Oct. 31; in 2016, the total return was 8.1 per cent for that period. Selling in May would have been a bad idea in both years. I don't know what the return will be from May through October this year, but I'm not going to sell my stocks - which would mean paying capital-gains taxes and missing out on half a year of dividends - because of some half-baked seasonal theory.