Choose carefully when parking cash

Different options require deliberation

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By Kim Inglis

Cash reserves held by Canadians have risen significantly since the global financial crisis. Earlier this year, CIBC World Markets reported that Canadians currently hold $75 billion in cash. That's almost 10 per cent of the total value of overall personal liquid assets in Canada. CIBC also noted that, in the past year alone, cash positions are estimated to have risen more than 11 per cent. And that is the fastest pace since early 2012.

Much of the increase can be linked to lingering fears about market volatility. Cash can protect capital over the short-term but it has long-term implications for portfolio growth, particularly when factoring the corrosive effects of inflation. Regardless, cash is an important component of any portfolio but it requires appropriate management.

Preparation requires a focus on capital preservation, income generation, and a readiness to act. These criteria dictate that some of a portfolio be held in cash. However many people inadvertently end up with different liquidity than originally intended because they made hurried decisions. This is too often the case with GICs.

Consider investors who are sitting on cash because they want to seize opportunities when prices are right. They don't have an immediate use for the cash, but neither do they want it sitting in the bank earning little interest, so they buy GICs.

This method of storing cash becomes an issue when the investor wants to move quickly but discovers that the GIC was rolled over on maturity and their money is not available. Instead, the funds have been locked in for another term by an automatic process that many financial institutions use if not instructed otherwise.

To avoid that scenario, an investor should know the terms prior to investing and, if they choose a GIC with an automatic rollover, they must note the maturity date. This will allow them to contact their advisor in sufficient time to implement other courses of action such as taking advantage of opportunities or adjusting an asset mix.

Automatic rollovers are doubly disadvantageous when processed without consideration of other products on the market. Depending on interest rates, money market or other fixed income alternatives may be more suitable storage vehicles than GICs. Investors may want to explore alternatives like high interest savings accounts, and certain government or corporate bonds, depending on their quality.

GICs are not all created alike and investors must understand what they are purchasing. For example, deposit insurance varies depending whether at a bank or from a credit union. At banks or trust companies, GICs with terms of five years or less are protected up to $100,000 by the Canada Deposit Insurance Corp (CDIC), a federal Crown corporation. Credit unions often have greater coverage but fall under their own provincial deposit insurance plans. For instance, the Credit Union Deposit Insurance Corporation (CUDIC), a statutory corporation, guarantees all deposits and non-equity shares of British

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Columbia credit unions as set out in the Financial Institutions Act.

Kim Inglis, CIM, PFP, FCSI, AIFP is an Investment Advisor & Portfolio Manager. The views in this column are solely those of the author. www.kiminglis.ca