Question
SERVING WHISTLER AND PEMBERTON

YOUR MONEY

DECEMBER 10, 2009

Kim Inglis, BCom, CIM

Don't let inflation erode your portfolio's value

According to the Investment Funds Institute of Canada, October saw $2.54 billion in money market fund redemptions as investors began shifting into long-term fund asset classes. However, $59.3 billion remains in money market funds.

Investors holding those funds continue to be cautious, perhaps wondering about the current level of equity valuations or wanting to see more evidence of recovery before they invest elsewhere. If that's you, don't let prudence in your financial affairs detract from your financial well-being. You can make better use of your cash than simply holding money market funds.

In a money market product, you're likely losing money as inflation nibbles at your savings. Most so-called high interest money market vehicles offer rates below 1%, which means that inflation is eroding cash holdings. Fortunately, you have alternatives.

For the most direct inflation hedge over the long term, look at Real Return Bonds. If held to maturity, Government of Canada Real Return Bonds guarantee returns above the rate of inflation. The principal and interest payments are adjusted higher with rises in consumer prices; reducing worry about the future income stream on the conservative side of your portfolio.

If you're investing large sums of money, consider buying Real Return Bonds outright. The Canadian government recently auctioned $700 million of 2.00% Real Return Bonds due Dec. 1, 2041. If you prefer a more diversified approach, look at the Phillips, Hager & North Inflation-Linked Bond Fund or the iShares CDN DEX Real Return Bond Index Fund (TSX: XRB).

Gold is another excellent hedge against inflation, having a very low correlation with other asset classes and offering protection during uncertain economic times. Credit Suisse recently reported that the price of gold tends to rise when the real Fed Funds rate is below 2%. The actions of the US government indicate they are unwilling to take risks with their economic recovery, so it's likely that rates will remain low over the near-term.

Gaining exposure to gold is fairly easy. The Claymore Gold Bullion Trust (TSX: CGL.UN) provides direct access to bullion and is USD currency exposure hedged back to the Canadian dollar. For diversification look at the iShares CDN S&P/TSX Global Gold Index (TSX: XGD), which provides broad exposure to a basket of gold producers including Barrick Gold Corp., Goldcorp Inc., and Newmont Mining Corp.

For those with a higher risk tolerance, another alternative to money market is high quality, dividend-paying investments. They keep more in your pocket than money market instruments, which are taxed as income; they offer an attractive income stream (many have yields in excess of 4%); and they tend to be defensive in nature.

If you wish to invest some of your cash in good quality, blue-chip investments, make sure you maintain a defensive stance. In particular, look at the utilities, telecom, and the food and drug companies. Generally speaking, the defensive names have lagged the recent rally, which means they offer more attractive entry points for long-term positions. They've historically provided good downside protection, so they should fair well in the event of any near-term bumpiness.

Don’t let inflation erode your portfolio’s value

Continued from Page 1

TransCanada Corp. (TSX: TRP) is a good example. It is a well-run company whose yield is very competitive with those offered by the banks. In fact, currently only two of the ‘Big Six’ banks offer a higher yield. TransCanada has a solid history of dividend payment, having paid them since 1964. And, Canadian utilities have historically offered better total returns on a risk-adjusted basis than the overall stock market.

Kim Inglis, BCom, CIM is an Investment Advisor. The views in this column are solely those of the author. www.kiminglis.ca