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GICs aren't as simple as they seem

Many types and situations to consider before stashing cash

Many nervous investors wanting to avoid short-term market fluctuations have been turning to GICs, comforted by their security and constant growth. Putting money into secure vehicles is a sound idea but, like any investment, it requires thinking and number crunching.

To begin, there are many different types of GICs. Principal is protected but returns can vary with some fixed; some based on the performance of market indices; and others linked to a prime interest rate. There are also various redemption options.

Determining the percentage of a portfolio to put into GICs is critical. If the percentage is too great, it becomes difficult to achieve retirement goals. There are rules of thumb, such as holding an amount of cash and fixed income proportionate to your age (i.e. 70 year-old investors should have 70% in cash and fixed income), but the bottom line is that the right mix depends on an individual's objectives and time horizon.

GICs have the advantage of safeguarding your principal but the returns are corroded by inflation and taxes. You can't do much about inflation but you can mitigate the effects of taxation by using your RRSP to defer it to a time when your marginal rate is lower, or you can eliminate taxes by using your TFSA.

Planning is important. One GIC strategy is "laddering", which safely maximizes returns by reducing the effects of interest rate fluctuations. It also provides ongoing liquidity. Laddering is achieved by dividing the investment amount over time.

An investor begins by investing equally in five GICs of one to five-year terms. That is, a $10,000 sum becomes five $2,000 GICs. Annually, as each fifth of the portfolio matures, the investor uses that fifth to purchase a five-year GIC. In five years the entire $10,000 sum and the interest earned are in higher rate five-year GICs, and the liquidity advantage is maintained.

Choosing the right payment frequency is key. If a regular income stream from your GICs is not required, you can take advantage of the compound interest offered by some issuers. Interest can be paid monthly, semi-annually, yearly, or at maturity but rate advantages are generally tied to longer maturity dates.

Don't forget the roll-over date. Many people invest in short-term GICs at competitive rates of return but fail to pay attention when they mature. In the absence of guidance, many financial institutions automatically roll GICs over at the posted rates, while ignoring higher yielding products. If the posted rate is lower than comparable products, the investor loses.

Investors should pay specific attention to product safety. The Canada Deposit Insurance Corporation (CDIC) is a federal crown corporation set up to protect Canadians' savings from failure of banks, credit unions, and other CDIC member institutions but it only insures the first $100,000 of insurable deposits.

Examining the credit quality of different insurers when investing larger sums will require professional advice, as it is easy to become overwhelmed with the different

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Continued from Page 1

rating systems. However, it is an important task when conservative funds are at stake.

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