Low risk, fixed return fuel resurgence of GICs

By SCOTT FRYER

Less risk. Reasonable return. It's what clients today are increasingly demanding. Their feelings continue to be fueled by recent volatility in the global stock markets, heightening that need for security and reinforcing the importance of a balanced portfolio.

For the past number of years investors and their advisors have not given GICs as much love as they did in the '90s. During that time, GICs were yielding as much as five or six percentage points above inflation. But many advisors are making the case for the strong return of the GIC given its stable earning power in a turbulent environment.

Every balanced portfolio should have some allocation of fixed income, and among the fixed income investment options, GICs are exceptionally attractive.

GICs versus the alternatives

A safe investment for risk-averse investors — one that also has the backing of the Canadian Federal government – is government bonds. However, interest rates on these bonds remain significantly lower than on GICs. In fact, GIC yields at present are 90-100 basis points higher across all terms than comparable government bond yields.

On a $25,000 investment, the higher GIC yields represent an additional $1,300 of income over a five-year period — or put another way, 1.5 times what would be earned on the government bond.

Canadians also love to park some of the fixed income portion of their portfolios in money market funds, another alternative that GICs significantly outperform.

Comparing the product alternatives over time, someone investing $100 in August 2010 in three types of investments would find their principal three years later looking like this: $107.35 with GICs; $104.50 with government bonds; and $101.70 with money market funds.

Safer at any age

A message that is also important to clients is that GICs are a sensible part of a diversified investment portfolio at any age, debunking the view that it is an investment tool only for the older generation. The following are a few examples of the type of individuals who will likely be keen on preserving the value of their capital and earning enough interest to stay ahead of inflation:

• Couples who are savings for their children's post-secondary education. The closer their children get to university age, the less willing they'll be to risk losing money they've put into RESPs. Parents want to protect their principal and improve their children's prospects for a debt-free education.

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• Young couples saving for a big purchase. Whether they decide to put money into a TFSA/GIC in order to save up for a big purchase such as a wedding, house, or other major life events, with a GIC, they don't have to worry about the risk of losing some or any of the money they need to fund their dream.

• Rainy-day savers. GICs are an excellent way to simply put money aside for rainy days, especially when interest is compounded within tax-sheltered plans like TFSAs.

• Die-hard conservatives. Some people are just conservative no matter what their age — they can't tolerate stock market volatility, especially in light of the roller coaster ride in 2008 and 2009.

Laddering GICs

If access to cash is important to your client, laddering GICs with different maturity dates can ensure they always have a portion of their cash accessible in any year. Laddering GICs entail staggering the maturity dates of investments so that one-fifth of a GIC portfolio would mature each year for five years. It can often be done with as little as $5,000.

By laddering GICs, investors also get the benefit of short and long-term investments: the liquidity of a short-term investment and the higher interest rates of a long-term GIC. Five-year GICs have the highest rates and allow investors to maximize their returns. Here's how to build a GIC ladder:

• Purchase five GICs in equal amounts staggered to mature in 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 GICs mature, each GIC should be renewed for a five-year term to maintain the effectiveness of the ladder.

With the laddering strategy, investors will have liquidity since GICs mature every year. Also, investors will have their funds invested in longer-term GICs at the highest rates available at the time.

Shop around

GICs are a very competitive market so investors have lots of choice. Purchasing a financial investment is no different than purchasing any other big ticket item so shopping around is always good practice. While the product is relatively standard, rates can vary widely, so investors should do their homework. A recent shopping trip indicated that five-year rates varied by an astonishing 1.16 per cent – from 1.75 per cent to 2.91 per cent.

GICs offer a good news message for financial advisors and their clients at many stages of their life who want security and a healthy return — they're definitely worth another look.

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Many considerations to tackle upon return

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adian scholarship, bursary, fellowship or research grant.

Some deductions which your client may become eligible for in the year they move include the ability to split pension income and the ability to deduct support payments. If, for example, your client or their spouse were residents of Canada as of Dec. 31, your client could elect to split his qualifying pension income. It does not matter that he was not a Canadian resident for the entire year.

Similarly, if your client becomes a Canadian resident and makes support payments to an ex-spouse/partner, they may be eligible to deduct the support payments even if the former spouse/partner is not resident of Canada.

However, only Canadian source income would be subject to Canadian tax for as long as the client maintains non-resident status.

If your client is coming from a country with a lower tax rate than Canada, consider seeking the assistance of a tax advisor before making any decisions as your client's worldwide income will be taxed at a higher rate than in the past.

The following is considered

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foreign income:

• Foreign employment and investment income;

• Foreign property;

• Foreign business investments; and

• Foreign retirement plans.

Your client's foreign income will have to be reported on their Canadian tax return, and may require additional disclosure forms, in particular for any foreign investments held, even if they are held in a Canadian broker account.

There are other issues to consider that could make the tax planning a little more complicated, such as if your client moves to Canada through an employment transfer.

The importance of speaking with your client to explore all the opportunities and potential challenges of establishing residency in Canada cannot be overstated.

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