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Looking for safety? Just buy GICs: A trip to your local bank can help you sleep at night

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One of the pitches hedge fund marketers make to mutual fund investors is to suggest their "absolute" returns will beat "relative" returns.

As last Wednesday's column on John Mauldin highlighted, real or absolute returns mean a given investment is supposed to provide a positive return, no matter how financial markets behave.

This contrasts with the relative returns of "long-only" equity mutual funds -- considered world beaters if they lose "only" 20% in a year when the S&P 500 loses 22%. This allows a fund's marketing department to bray that it "beat" the S&P500, even if your \$10,000 investment is now worth only \$8,000.

The benchmark for hedge funds is therefore money market funds, rather than certain stock indexes. However, the jury is still out whether this different point of comparison means hedge funds will do any better than mutual funds in the long run. I have my doubts, as does Forbes magazine. Its May 6 cover story is entitled The Sleaziest Show on Earth. It described hedge funds as "a business rife with exorbitant fees, phony numbers and outright thievery."

A bit over the top, perhaps. What's intriguing is the psychology of measuring risky investments against cash. If your goal is to sleep at night and generate positive returns, you don't need go through the contortions of finding the rare acceptable hedge fund.

Lest we forget, millions of Canadians need go no further than their friendly local bank branch to locate guaranteed investments which may or may not outpace money market funds. Regulators even let them use the phrase "guaranteed investment" right in their product name. Yes, we're talking the humble GIC, or guaranteed investment certificate, also known as term deposits.

These are the focus of a timely new book published by the Federation of Canadian Independent Deposit Brokers. It's called Seven Strategies to Guarantee Your Investments, and is written by mutual fund salesperson **Jim Yih**.

We've seen Jim in this space before, after he wrote a mutual fund book called Mutual Fundamentals. His follow-up on GICs is dubbed a "Guide for the Conservative Investor," including his own late mother, to whom the book is dedicated. Amen to that, since my own departed dad was a GIC man to the end.

Clearly, many in the Depression-era generation never did become "GIC refugees." In the early 1990s, mutual fund marketing consultant Dan Richards coined the term GIC refugee to describe investors whose natural inclinations may have been GICs but who fled them for what then appeared to be the more lucrative returns of equity mutual funds.

Yes, back in the days of the ever-rising bull market, relative returns were considered a good thing. A decade later, those who believe we are in the early stages of a "secular" bear market argue GIC holdouts may yet have the last laugh over GIC refugees.

Clearly, many never left the GIC homeland in the first place. Canada's retail guaranteed investment market is worth \$350-billion, with 53% of Canadian investors holding at least one GIC. After one of the "worst bear markets in history" hit in 2000, many investors "now remember what they forgot," Yih writes. That's "the benefits and advantages of having guaranteed investments in their portfolio."

GICs and fixed income nicely complement non-guaranteed investments like stocks and mutual funds. Yih says investors are angry at the financial services industry and media for "creating all the hype about mutual funds and stock markets ... investors are tired of losing money and who can blame them?"

GICs have stood the test of time as "one of the only investments to PROTECT YOUR CAPITAL." (Yih's emphasis).

Mind you, with such low risk comes modest returns. Throughout the book, Yih describes GIC returns of 3% or 4%. He also concedes that "arguably, it may be one of the worst times to move to low-interest fixed-income investments."

Nor can GICs be viewed as entirely risk-free. They provide poor inflation protection, are taxed highly and there may be security risk. That's why you should make sure you get your GICs from an institution belonging to the Canada Deposit Insurance Corp. (CDIC).

As with other investments, risks can be minimized and returns maximized by employing various strategies. Yih's first three are to shop around for rates, negotiate for better rates and shop for alternative products.

GIC variants and alternatives include high-interest bank accounts, Canada Savings Bonds, cashable and step-rate GICs, and principal-protected notes. Alternative fixed-income products include money market funds, government and corporate bonds, inflation-indexed real return bonds and bond mutual funds. There are also hybrids between the guaranteed and nonguaranteed worlds -- notably index-linked GICs and segregated funds.

Yih's fourth strategy is to understand safety, security and insurance, including the CDIC and CompCorp.

Strategy 5 is to ladder GICs with different maturities, and number 6 is to create an investment plan and incorporate proper asset allocation into it.

Yih revives the old rule that the percentage of guaranteed investments in your portfolio should equal your age -- so a 60-year-old would be 60% in GICs or equivalents.

The seventh strategy -- no surprise given the book's sponsor -- is to use a deposit broker to help you find the best rates. The FCIDB was founded in 1987; you can learn more at www.fcidb.com.

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