



# WHAT'S THE PEACE OF MIND OF GICs COSTING YOU?



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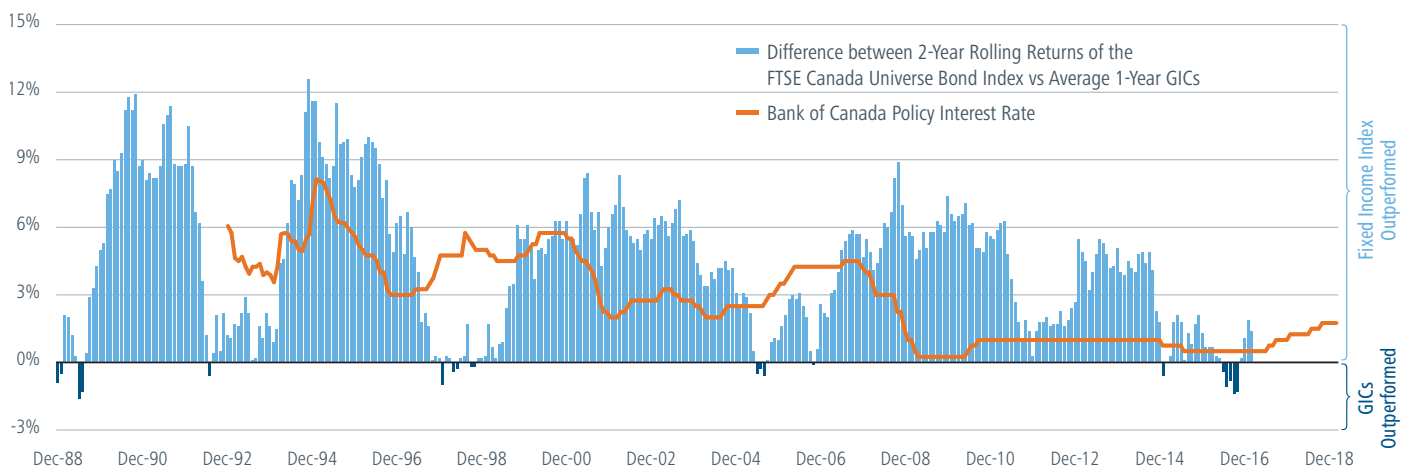
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During times of market volatility, a natural tendency for investors is to shift their mindset from capital growth to capital preservation. Often, capital preservation comes in the form of cash or cash alternatives such as GICs. GICs are easy to buy (one click from your bank’s website or at your local bank branch); easy to understand (you get a stable fixed rate in exchange for locking up your money); and you know when you’re getting your money back.

## The opportunity cost of GICs: are you leaving returns on the table?

What most investors pay little attention to is that peace of mind often comes at a cost – an *opportunity* cost. A diversified portfolio of high-quality fixed income investments offers some of the same benefits as GICs: relatively low credit risk (although not CDIC insured) and income. The one perceived drawback of a fixed income fund compared to a GIC is that the value of the investment can go up and down as bond yields fall or rise. However, over a holding period of two years (a common term for GICs), fixed income funds have historically outperformed GICs the majority of the time. The opportunity cost of choosing GICs is that foregone return.

### Rolling 2Y excess total return of FTSE Canada Universe Bond vs Average 1Y GICs



Source: Bloomberg, Morningstar Direct. As of Feb 28, 2019, the rolling return data in this chart has been lagged to reflect the start date of the 2Y rolling period so it aligns with the Bank of Canada policy rate at that time.

History suggests the best time to be in GICs is right around the beginning of a rate hiking cycle by the Bank of Canada (Bank of Canada policy rate shown in the orange line on the chart). As the hiking cycle becomes more advanced, GICs no longer demonstrate an advantage and in fact have often produced returns several hundred basis points below what a bond portfolio generated over the same period.

## Opportunity Cost of GICs

Savers, in particular, appreciate the fact that the value of GICs on their statements never goes down. We would point out that they only have to lengthen their investment horizon modestly – from quarterly statements to, for example, two or three years – to put the “risk” of bond funds and the opportunity cost of GICs in perspective. Looking at twenty years of data, 10% rolling one-year returns of a broad basket of bonds (represented by the FTSE Canada Universe Bond index) were negative but *none* of the rolling two-year returns were negative. A similar pattern emerges when looking at other types of fixed income investments, including investment grade corporates and even high yield (see table below). And, the incremental returns that have been achieved by the various fixed income segments are significant.

### Rolling total returns with 1-month shift Feb. 1999 – Feb. 2019

Investment Name	% of observations where...			Annualized Rolling Returns (1 Year)
	1 Year Rolling Return was Negative	2 Year Rolling Return was Negative	3 Year Rolling Return was Negative	
Canadian investment grade government and corporate bonds <sup>1</sup>	10%	0%	0%	5.1%
Canadian investment grade corporate bonds <sup>2</sup>	7%	0%	0%	5.2%
Canadian high yield bonds <sup>3</sup>	15%	3%	0%	6.3%
Average 1 Yr GIC	0%	0%	0%	1.6%
Average 5-Yr GIC	0%	0%	0%	2.7%
<i>Time range:</i>	<i>2/1999 – 2/2019</i>	<i>2/2000 – 2/2019</i>	<i>2/2001 – 2/2019</i>	
<i>Number of observations:</i>	<i>241</i>	<i>229</i>	<i>217</i>	

Source: Morningstar Direct, as of February 28, 2019.

<sup>1</sup> FTSE Canada Universe Bond

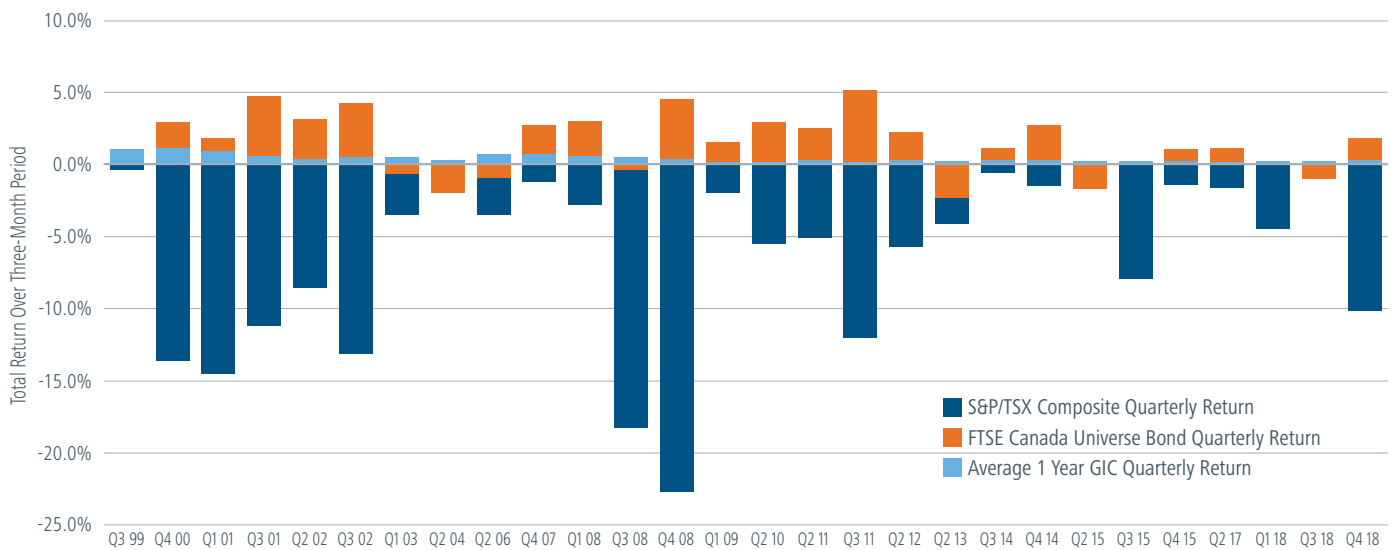
<sup>2</sup> S&P Canada IG Corp Bd TR CAD

<sup>3</sup> S&P Canada HY Corp Bd TR CAD

## GICs never go down, but they never go up either

Finally, when equity markets are stressed, bonds have historically provided an effective counterbalance to equity volatility in a portfolio. In most quarterly periods over the past twenty years when Canadian equities were down, the total return on a broad basket of bonds was positive – and significantly more positive than the interest income earned on a GIC during that period.

### Core Fixed Income and GIC Returns in Quarters in which Equity Returns were Negative 1999 – 2018



Source: Morningstar Direct, as of December 31, 2018.

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