Assante WEALTH MANAGEMENT

Assante Capital Management Ltd.
Member – CIPF

Janine Purves, CFP
Senior Financial Advisor

9130 Leslie Street, Suite 302
Richmond Hill, Ontario L4B 0B9

T: (905) 707-5220 Ext. 22
F: (905) 707-1035
Toll Free: 1-866-526-4636
E-mail: jpurves@assante.com

Fixed Income: Is there anything left to buy?

Written by Janine Purves, CFP, CPCA

Bonds yields are at the lowest point we've ever seen them.

Interest rates are historically low as well. We know they have to go up sometime, but what does that really mean. Are there any places to invest that will pay more than 1-2%, and not take on full equity risk?

The search for fixed income is never ending in these uncertain markets. "Fixed Income – What Can we do for Income" also available on my website. I wrote about some options last year that offered different strategies, and exposure to fixed income that went a little beyond traditional government bonds. While some of these ideas still apply, virtually all bonds can be caught in a losing position when interest rates start to rise.

To better understand why the value of a bond can go down as interest rates go up, let's review an example. Let's assume you own a bond worth $100 that is paying you 4% and maturing in 1 yr. If interest rates moved higher to 5%, you could not sell your bond for $100 anymore. As anybody purchasing it would want 5% interest to equate with the going market rates. You would likely sell it for approximately $99. That would give the purchaser a benefit of $1 when it matured, plus the 4% interest it pays. This would approximate the 5% interest rate of the market. Now picture if bonds are maturing in 10 years. This same situation would happen for each year. This is the challenge with low yielding bonds and the potential for increasing interest rates. There is actually potential for loss in the short-term.

Please keep in mind that many fixed income products that are managed will shift the holdings to help better manage this challenge. To better manage increasing rates, shifting to shorter term bonds is a common tactic, and also purchasing higher yielding bonds, those that pay a little better yield. The higher yield helps to soften the loss as the yield is often more than the drop in market value. While there are potential for losses when interest rates start to shift, bonds are still far less volatile than equities.

As with anything, increase the demand and we'll see an increase in price, but also an increase in options. That is what is now happening, as we've had a tremendous increase in Fixed income indexes and strategies to help offset the volatility and inflation concerns that surround us.

One more fixed income opportunity is becoming available in Canada; that is Floating rate corporate loans. These are secured loans held by corporations that have been issued and sold on certain terms. These are short-term loans issued to companies with below-investment grade credit. The rate of interest charged on these floating rate bank loans tends to reset frequently, perhaps once per month or once every three months and is tied to the LIBOR rate. The benefit of the floating rate is simply that as interest rates increase, the “rate” increases on the loan, hence the term floating. Generally these rates are set at Prime + 2-4% depending on the terms and the security being offered. The 2nd benefit is these loans are generally well secured by the assets of the company, and this can include real estate, stock, cashflow, equipment, and virtually anything of value. While loaning money to a corporation that is not trading on the stock market will always be considered more risky than the highly rated corporate bonds and most government bonds, the fact that this is secured can offset some of the risk. In addition, the senior secured loans are actually given priority over conventional bond issues in a default situation.

What’s new is that these types of loans have been strong opportunities in the US and have provided better yields than many bonds historically. Also, they are less susceptible to lose value as interest rates rise as the rate increases in that environment, similar to real return bonds. However floating rate loans have a far broader supply than real-return bonds, so are far easier to purchase.

Please also keep in mind the risks. They can drop in value when the equity market falls, and while they are secured, they still do fluctuate more than government bonds. You are taking on the company risk, but by buying through a diversified product, you are also hiring the credit manager that oversees these products. Ensure they have a solid track record in the industry. The largest floating rate loan managers in North America are: Eaton Vance, Invesco, Babson capital, Pyramis, Blackrock, ING and Hartford (as sourced by S&P’s Leveraged Commentary and Data). These loans are now becoming more readily available in Canada to purchase as part of your fixed income exposure. There are a few different options through fund companies, and also a new index. The 3 that I am aware of are: AGF (managed by Eaton Vance), Trimark Invesco, and a Powershares ETF, trading under the symbol of BKL on the TSX (Cdn dollar hedged) and BKLN, trading on NYSE. More products are available, and will continue to come onstream as this sector continues to gain interest in Canada.

As always, when looking at new investment options, ensure you are considering the risk, and that you discuss your financial challenges with your investment advisor for the right fit.

Janine Purves is a Senior Financial Advisor at Assante Capital Management Ltd specializing in wealth planning for business owners, & professionals helping your retirement dreams to come true. Phone: 905-707-5220 ext. 22
E-mail: jpurves@assante.com, Website: www.JaninePurves.com