



# **CANADIAN INVESTORS' COURSE**

## **Session 2 – Income Investing Continued Commentary**



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# Canadian Investors' Course



- 1. Bond Market Potential Danger**
- 2. It's really different this time**
- 3. Understand what you own**
- 4. Don't become a 'Pie Chart' victim**
- 5. Rate-reset Preferred Shares**



## Bond Market Potential Danger

- the great advantage of bonds is price predictability
- it's about Math
- Example:

Buy \$100,000 of a 10 year bond for \$100 with a coupon (interest rate) of 3%. What happens to this bond price if interest rates go to 2% or 4% ?

- At 2%, the \$100,000 bond can be sold for \$109,020
- At 4%, the \$100,000 bond can be sold for \$91,825
- The gains and /or losses in this scenario are greater with longer term bond (20 year, 30 year etc.)



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## It's really different this time

The 2008 - 2009 global financial crisis left a huge over hang of unusually low interest rates. Huge capital gains were earned since 2008 as a result. Where do we go from here?

Would you buy longer maturity bonds now? Do the Math.

### **Government bond yields today (August 2016):**

Canada 5 year - 0.58% today. Rate was 4.0% January, 2008

Canada 10 year - 1.05% today. Rate was 4.0% January, 2008

Canada 20 year - 1.62% today. Rate was 4.25% January, 2008

Canada 30 year - 2.18% today. Rate was 4.75% January, 2008



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## What type of gains were earned since 2008?

If you bought \$100,000 of a Canada 30 year bond January, 2008, today this bond could be sold for *\$156,370.00* and that doesn't include interest received!

How did bond funds perform? Look at the next slide of the BMO bond fund. This is a typical bond fund you can buy at a Bank:



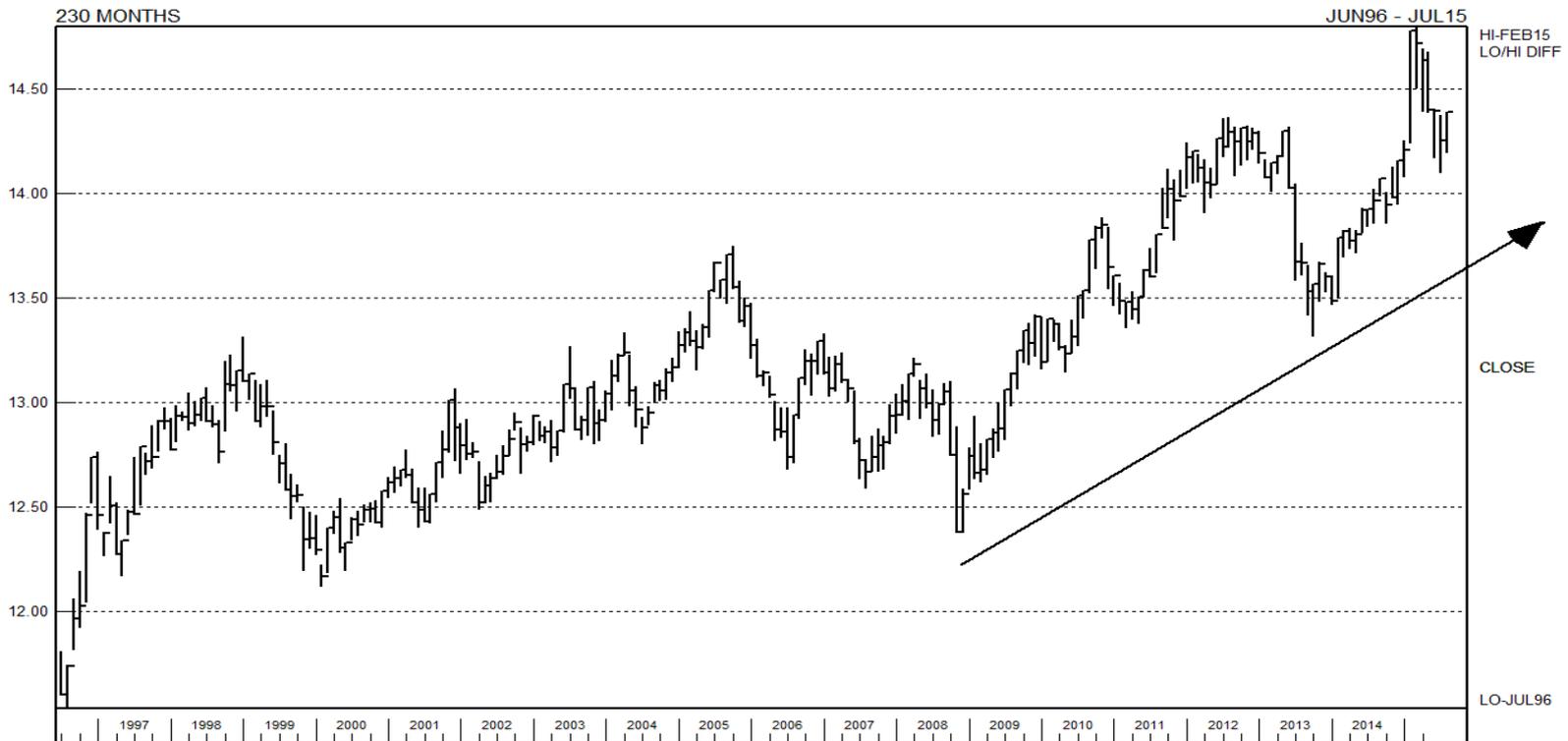
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## Understand what you own!!!

BMO bond fund moved up as interest rates fell, however, the next slide compares this fund with the 10 year Canada bond yield. It is VERY important to note the similar inverse patterns.

BMO BOND - A





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BMO BOND - A



CDA 10YR BOND YIELD

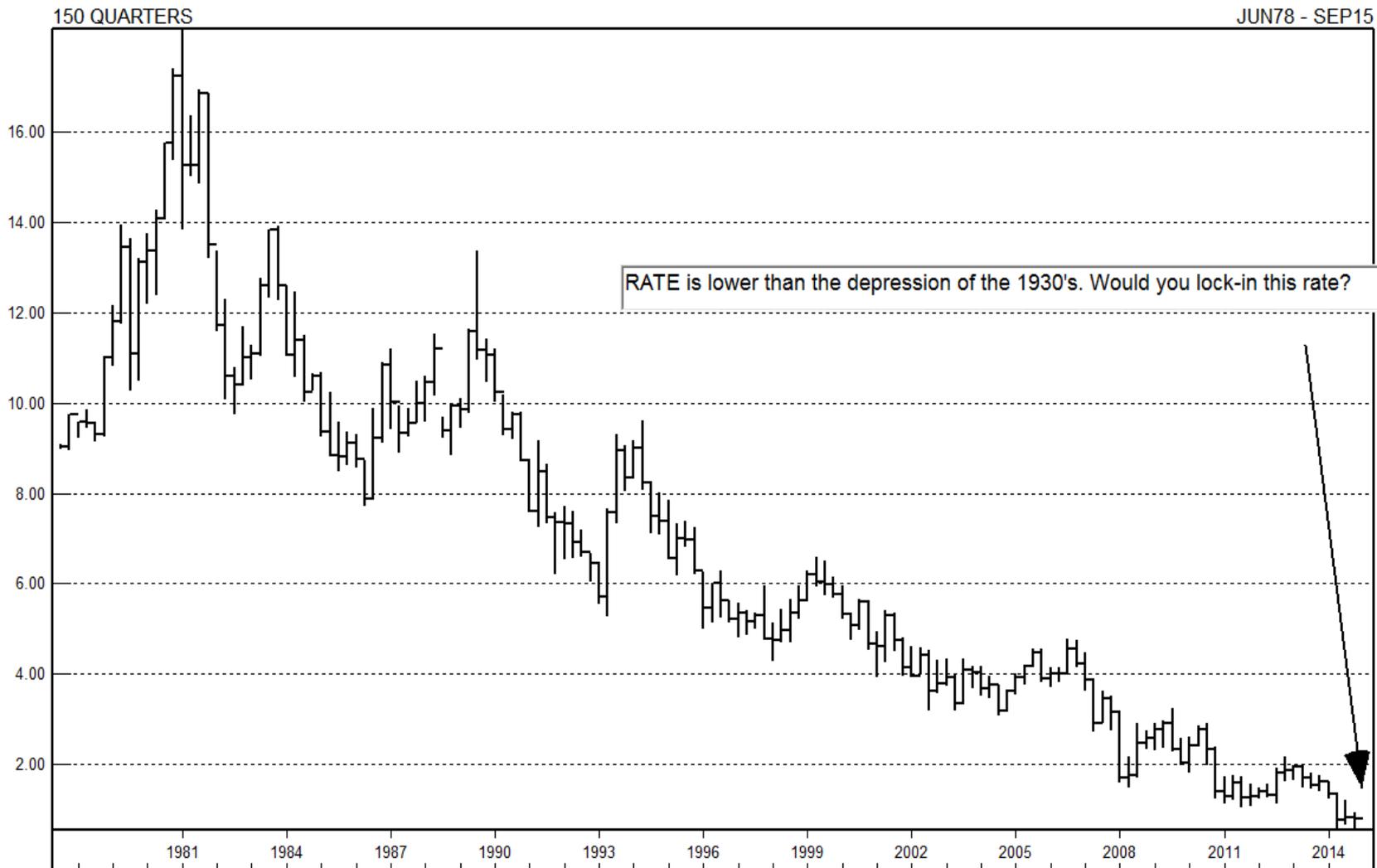




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CDA 5 YR BOND YIELD



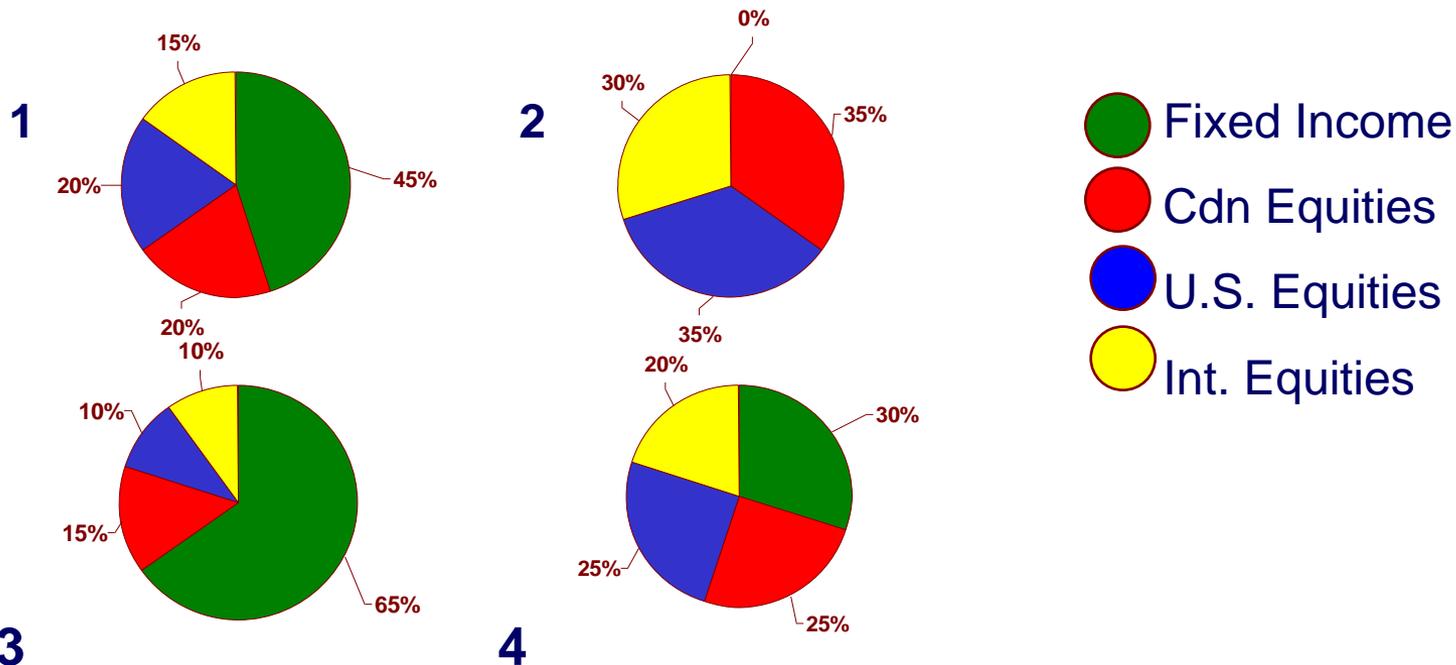


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## Don't become a victim of the pie-chart

Remember this question from the beginning of Session 2?



**Answer: 1. Balanced 2. Aggressive Growth 3. Conservative 4. Growth**

Those are the official answers that Canadians are subject to. **NOW THAT YOU KNOW HOW A BOND WORKS**, based on current interest Rates, would you call the 'conservative' portfolio **CONSERVATIVE**? It may be time to revisit you current asset mix in your fund portfolio! You may also learn something about, both, the restrictions of your Portfolio and your planner/advisor. Important topic for a later lesson.



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## Rate-reset Preferred Shares



### Rules:

Shares are a form of corporate debt, not a common stock.

Shares are issued as new shares at \$25 per share.

These shares pay a 'set' quarterly dividend for 5 years and then one of 2 things can occur:

1. the issuing company can buy back your shares for \$25, or
2. the dividend rate will be reset. The new yield will be a pre-set number, PLUS whatever the Canada 5 year rate is at that time. Example:

A major Canadian bank can issue a Rate reset on any given day for \$25.

The yield may be 5% per year guaranteed by the Bank for 5 years. After the initial 5 year period, the Bank can buy back the shares from you for \$25 or you will receive a new yield of 4.50% + the 5 year Canada bond yield at that time.

- Suppose the 5 year Canada bonds are yielding 2% 5 years from now, then the new rate will be  $4.5\% + 2.0\% = 6.5\%$

**This example reflects an actual preferred that was issued in 2016. Great for investors that need income.**



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## Rate-Reset Preferred Shares

THIS INCOME INVESTMENT ALSO OFFERS THE DIVIDEND TAX CREDIT, YOU KEEP MORE AFTER TAX DOLLARS!

All Canadian banks and many utilities are issuing these preferred shares.

You get good quality investments (P2 rating), more than double the income than a 5 year G.I.C. offers, and protection from rising interest rates in the future. Is this what suits you? If this enough of a predictable return, then why take any more risk? Now you're educated.

Please use the Postal Code LOCATOR on the website to find a Trusted Wealth Professional that can acquire Rate-Reset Preferred shares for your portfolio. *Knowing how* to find the right preferred share that is safe and suitable is VERY important.



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