CANADIAN INVESTORS' COURSE

Session 2 – Income Investing Continued

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BAILOUTS
Deficits
SIGNE

Session 2 – Medium and Long Term Income Investing

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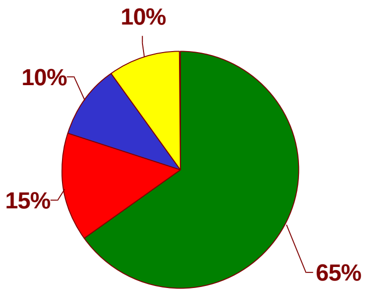

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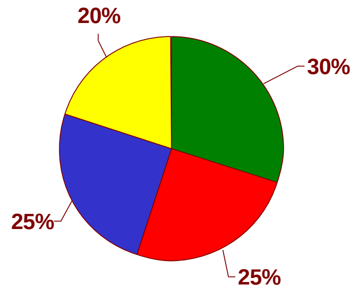


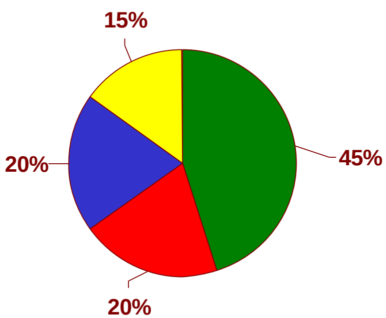
2.________________

Fixed Income

Cdn. Equities

U.S. Equities

Int. Equities



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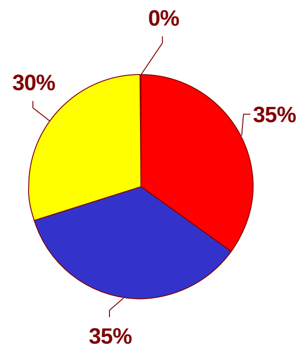

4.__________________

Conservative - Aggressive Growth - Growth - Balanced

- Bond Market
  - Has an asset attached
  - 'mortgage bonds' (First Canadian Place default in 1991)
- Debentures… differences?
  - Has no asset attached just the good credit of the company

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- What is a Bond?
- What does it look like?
- What makes bond prices move?
- Bond Pricing and examples
- Profiting and losing money in the bond market
- How do you buy bonds?
- Types of Bond investors

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Bond Example

Province	$500 Apr. 15, 2014	$500 Apr 15, 2019
of	$500 Oct 15, 2014	$500 Oct 15, 2019
Ontario	$500 Apr 15, 2015	$500 Apr 15, 2020
	$500 Oct 15, 2015	$500 Oct 15, 2020
$20,000	$500 Apr 15, 2016	$500 Apr 15, 2021
	$500 Oct 15, 2016	$500 Oct 15, 2021
5%	$500 Apr 15, 2017	$500 Apr 15, 2022
	$500 Oct 15, 2017	$500 Oct 15, 2022
Oct. 15, 2023	$500 Apr 15, 2018	$500 Apr 15, 2023
	$500 Oct 15, 2018	$500 Oct 15, 2023

Issuer – Province of Ontario

Face Value – $20,000

Coupon (interest rate) - 5%

Issue Date – Oct. 15. 2013

Maturity Date – Oct. 15, 2023

Payment frequency – semi annual

Interest payment - $500 (every 6 months)

THE BOND MARKET

- What makes bond prices move?
- Interest rates
- Risk of issuer
- Economy (we will do again later)

Interest Rates and Price

Bonds are issued at $100 face value and mature at $100 face value, with interest payments between the issue and maturity dates, however, an investor can buy and sell a bond on any given day the markets are open…but at what price?

- Interest Rates ↑ Bond Prices ↓
- Interest Rates ↓ Bond Prices ↑

- **Ratings: Risk of Issuer (rating change)**

  Best – AAA, then AA, A, BBB, BB, B, ETC.

- Stick to 'A' or better to avoid surprise
- 'BBB' is OK for Provincial bonds
- Make sure that the make-up of a bond fund matches your tolerance for risk – don't accept 'good quality' as an answer
- A conservative Bond fund should contain less than 30% corporate debentures, ask your fund sales person, they should have the answer

- **Economy changes prices**
  - 2008 bond boom (stock market crash)

Examples of bond price movements

currently both bonds sell for $100:

Bond exercise #1 – rates fall 2%

(currently both bonds sell for $100) – Assuming Oct. 15, 2016

5 year – Gov't of Canada 5% Oct 15, 2021

Today's Value = $109

20 year – Gov't of Canada 5% Oct 15, 2036

Today's Value = $130

Bond exercise #2 – rates rise 2% ($100 today)

5 year – Gov't of Canada 5% Oct 15, 2021

Today's Value = 91.50

20 year – Gov't of Canada 5% Oct 15, 2036

Today's Value = 78.50

How to buy a bond

Prices – bid/ask

accrued interest

http://www.zenwealth.com/businessfinanceonline/BV/BondCalculator.html

Bond price rules:

- The longer the maturity date, the more volatile the price of the bond, and vice-versa
- Price of a bond is affected by a change in credit rating
- Bonds mature to the original issue price: $100
- You can make a significant amount of money trading the bond market (can make capital gains too)
- By buying and selling bonds you are a 'rate' anticipator
- Bond funds move up and down with rates too (see commentary)

Preferred Shares

- Similar to stocks
  - Pays Dividends, not interest
  - May not have a final maturity (perpetual)
  - Trade on the Stock Exchange
- Similar to bonds
  - Preferred dividend is a fixed dollar amount
  - Has a "par" value ($25)
  - Interest rate movements affect prices
  - Credit rating – P1, P2, P3 …
  - May have additional "special" features

Preferred Features

- Preferred shares are issued at $25 per share
- Set dividend, pays quarterly
- Retraction – investor has an "out" option
- Redemption – issuer has an "out" option
- Fixed/floater
- 'Rate Reset' preferred (watch the Commentary) video after this lesson
- Perpetual preferred
- Convertible preferred

Taxation of Income

- **Interest income**
  - taxed at your marginal tax rate
  - i.e. $100 of interest is earned, the full amount is taxable at your marginal tax rate

- **Capital Gain income**
  - – investor is taxed on ½ the capital gain
    - i.e. buy 100 shares of BCE @ \$25 = \$2500
      sell 100 shares of BCE @ \$26 = \$2600
      earn \$100 capital gain on BCE
    - taxpayer reports only \$50 of income which is then taxed at their marginal tax rate

- **Dividend Income**
  - eligible dividends earned from Canadian corporations are grossed up by 38% (2012), then the federal dividend tax credit of 15.02% is applied
  - i.e. $100 dividend income, grossed up to $138

Federal tax	= $40.02	
Div. tax credit	= $20.72	(15.02% of $138)
Net Fed. tax	= $19.30	
Net Prov. tax	= $6.57	(Ontario)
Total tax	= $25.87	
You Keep	**= $74.13**	

Taxation of Incomes – Summary

- Interest income
  - 43.41%
- Dividend income
  - 25.87%
- Capital Gain income
  - 21.71%

assuming Ontario, and $100,000 of taxable income
as of June 30, 2016

2 Types of Fixed Income Investors:

1. Conservative
   - buys high quality bonds and debentures, BBB or higher
   - wants income from bonds
   - holds to maturity
2. Aggressive
   - hold them for a short term – 3 months to 1 year
   - tries to anticipate interest rate movements
   - buys long term bonds to maximize return
   - buys on margin

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