The High Opportunity Cost of GICs

Three Key Reasons to Choose Bond Funds Over GICs

While many investors view GICs as a potential source for reliable risk-free returns, we believe their investment appeal is greatly diminished when one considers three key areas: return potential, tax efficiency, and liquidity (or lack thereof).

Considering Potential Returns

It's important to keep in mind that, over the long term, bonds have significantly outperformed GICs, but one can be forgiven for recognizing the recent advertised yields promoted on many GICs.

Unfortunately, such promotions neglect to address the potential tax inefficiency (more on this later), the lack of liquidity and the often-mundane returns generated from such securities when compared to comparable, and often the same, issuers. Take for example the comparison below of GIC rates to bonds from well regarded issuers, some of which are in fact issuing GICs too. At the time of writing, the bond yields seen in these bonds for a comparable term now exceed that of GICs while offering full-market liquidity and the ability to keep interest earned should the holder need the funds. This is unlike a GIC that often has material penalties or the requirement to relinquish the interest earned upon early redemption.

FIXED INCOME YIELD – 1 YEAR

ISSUER	SECURITY	QUOTED YIELD TO MATURITY
TD	TD 2.496 12/02/24	5.14%
Enbridge Inc.	ENBCN 3.95 11/19/24	5.28%
Bell Canada	BCE 3.35 03/12/25	5.22%

GIC – 1 YEAR

ISSUER	QUOTED YIELD TO MATURITY
TD	4.90%

Sources: 1832 Asset Management L.P.; TD Bank as of March 18, 2024

Tax Efficiency: Advantage Bonds

As yields climbed significantly in 2022, many bonds were priced at a discount, offering investors an opportunity to collect both interest income and capital gains if held to maturity. This is important because capital gains are taxed at a significantly lower rate than interest income. The after-tax return is even more appealing when considering the tax advantage of discount bonds.

Unlike bond funds, GICs offer only interest income, which may be taxed up to 53.3%, depending on one's total income.

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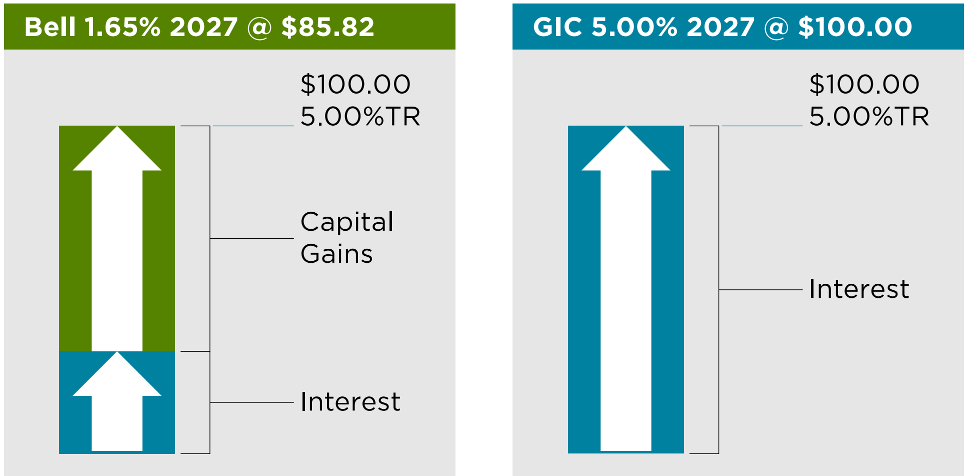
DISCOUNT BONDS FOR TAX EFFICIENCY

Total return includes potential for capital gains

Components of total return if held to maturity



Source: 1832 Asset Management L.P.

GICs: That Locked-In Feeling

Because they offer guaranteed rates of return, GICs are almost always required to be held until maturity. GIC holders who need to break their contract early will incur substantial penalties, which often include the loss of some, or perhaps all, accrued interest.

With a large secondary market to sell into, bond funds offer considerable liquidity in the event an investor needs to access those funds – either in an emergency or to pursue another opportunity offering a potentially higher return.

The Final Word

Ultimately, when held to maturity, GICs and bonds will return the full amount of their investment and their associated yields. However, bonds of a comparable term will almost always pay higher yields and possibly deliver superior tax outcomes (e.g., discount bonds).

As long-term active investors, Dynamic Funds believes bond funds present a much more compelling investment opportunity than GICs – even more so as central banks begin to hit the pause button on further rate hikes.

Contact your Financial Advisor to learn more.

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