MONEY Management

GICs - an interest-ing strategy

With the RRSP deadline fast approaching, many people are now allocating time to look at their investment options. Finding the most suitable financial vehicle is a key component of successful investing. Some Guaranteed Investment Certificates (GICs) are currently featuring attractive returns and this is resulting in a great deal of attention from investors.

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The objective of the GIC investor is to generate maximum returns while incurring minimal risk. Most purchasers of GICs experience an uneasy feeling when time comes to choose a term. Longer term certificates, such as five years, pay higher interest than do short-term certificates.

This higher interest compensates the long-term investor who sacrifices short-term liquidity. Nobody wants their funds locked up and inaccessible if rates rise, nor do they want to roll-over a maturing investment when rates are low. While hindsight is always 20/20, it is impossible to accurately and consistently forecast the direction of interest rates.

There is, however, a strategy that combines the higher rates offered through long-term certificates and the liquidity that comes with short-term certificates. In addition, this strategy will eliminate the guesswork of interest rate timing and stabilize your return during interest rate fluctuations. All of this can be accomplished by staggering your GIC portfolio.

Suppose you have $100,000 and you wish to employ this strategy for all of the above reasons. Divide the funds into five equal portions of $20,000 and invest those portions for a one, two, three, four, and five-year term.

At the end of the first year the portion invested for a one-year term matures. At this time you roll it into the highest yielding five-year term. At the end of the second year you do the same, and so on. After four years you will have the entire GIC portfolio invested at five-year terms with 20 per cent coming due each year. You continue this as long as you like by renewing maturing five-year certificates for an additional five-year term.

Investors who are just starting a portfolio can still employ this strategy. They simply make their annual RRSP contribution to a GIC with a five-year term. They repeat this purchase every year. The portfolio will develop automatically to a series of staggered maturity dates.

This strategy is appealing because when interest rates fall, only a portion of your money is affected. Regardless of what rates do in the future, you can rest assured you did receive the highest rate possible every time.

Finally, you have 20 per cent of your money maturing and therefore becoming liquid every year in the event of an emergency or opportunity. This strategy is simple to set up and easy to administer (particularly in a self-directed RRSP).

To maximize your returns invest as early as possible in the year and shop around as GIC rates vary significantly between institutions. By eliminating the guesswork of interest rate timing, it ensures more enjoyable and profitable GIC investing.

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