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Low interest rates will continue to challenge Canadian savers

If you are concerned about how today's low interest rates affect your investment performance, you are not alone.

The Bank of Canada has cut its prime lending rate 19 times in the last 22 months.

In turn, the interest rate on five year fixed-income securities is about six per cent. That works out to about three per cent after taxes and less than three per cent after inflation.

Why are rates so low?

This current down-trend in interest rates is not merely a function of monetary or fiscal policies. Instead, it results from wholesale changes in the population.

At the root of this upheaval are the baby-boomers – the first generation to decide voluntarily against replacing themselves. The number of people under the age of 35 is actually shrinking and this middle aging of the citizens of developed economies means that the overwhelming proportion of consumers are just not consuming on a grand scale.

Supply is dwarfing demand for money in capital markets and rates of return on fixed-income investments are being driven down to levels not seen since the 1950s.

And there is little evidence on the horizon that this situation is temporary.

Canada's performance in managing inflation – key determinant in the level of nominal interest rates – has been remarkable.

Fiscal discipline has also made a significant impact in wrestling federal and provincial debt loads to more manageable levels, so governments no longer compete as ferociously for funds in capital markets. More dollars are being placed in capital markets; fewer users are competing for them.

It is precisely because this trend is expected to continue that all Canadians must address how they will adapt their saving and investing behavior to assure their ability to capture returns needed for financial independence.

How to survive and thrive in a lower interest rate environment

Low interest rates, today and in the foreseeable future, are going to continue to challenge Canadians savers.

Many professional money managers feel rates will trend lower after the current volatility. This level of rates has taken the easy returns off the table. After all, what was easier than investing in the 1981 series of Canada Savings bonds at 19.5 per cent? Ninety-day treasury bills, which paid 17.7 per cent in 1981, are currently yielding 2.86 per cent. You also want to stagger your maturities so as not to be trapped with all your money coming due in a low interest rate period.

Reality today demands a reassessment of risk and risk tolerance. Over the longer term, spreading your risk over different types of investments can protect your purchasing power. Investing in stocks would have yielded superior returns over the past 20 or so years.

Indeed, stock market performance superseded fixed-income returns, even through the exceptional early '80s with the high bond yields.

Armed with professional advice, and a comprehensive plan that addresses your specific investment needs and goals, you can thrive in this lower interest rate environment.

This article was submitted by Michael Comeau, vice president and senior investment advisor of TD Evergreen Investment Services.