The Stan Clark Financial Team's

PERSPECTIVES

An excerpt from "Perspectives" - Volume 7 - Issue 6

Asset Allocation

High-yield bonds and preferred shares – it's not a free lunch

By Heather Guzak, Associate Investment Advisor

Interest rates have been low for a number of years now, prompting many investors to seek out higher yields in less traditional forms of fixed income. But higher rates do not necessarily mean better rates, since they usually mean higher risk, too.

Sometimes we will invest in riskier types of fixed income, depending on the situation and the market. For example, we may consider having some of your fixed income in high-yield bonds or preferred shares.

High-yield bonds are corporate bonds that have a low credit rating. Individually, these can have a high risk of default, as in, you might not get all of your money back. If the interest rate differential compared to government bonds more than justifies the additional risk, then we might recommend putting a portion of your fixed income into high-yield bonds. Also, to reduce the risk of any individual bond, we would typically buy bonds using a fund – so we end up with a diversified portfolio instead of just a few individual bonds. This is one of the few reasons we would own a fund.

Preferred shares are another fixed-income alternative. Preferreds are sort of a hybrid between a stock and a bond. In terms of credit seniority, they are below corporate bonds, but above stocks. They typically pay more than a corporate bond and can also have some tax advantages. The downside is that they are riskier and may have certain features that might end up costing you down the road.

In summary, we don't usually have much exposure to high-yield or preferreds. Instead, we want to keep our fixed income safe. And if we want to take on more risk for more returns, we would rather consider a higher exposure to stocks. ■

Heather Guzak is an Associate Investment Advisor for the Stan Clark Financial Team at CIBC Wood Gundy. She is responsible for the day-to-day monitoring and maintenance of client accounts and investment portfolios.

Asset Allocation

Bond ladders

By Elaine Loo, Associate Investment Advisor

One of the most important decisions affecting your risk and returns is figuring out how much to have in stocks versus bonds. Stocks usually generate the highest returns, but they also come with volatility. Bonds are used to provide for your short-term needs and to dampen the ups and downs in your portfolio – in other words, to reduce risk.

We like to keep our fixed income invested for the purpose it is intended for: to reduce risk. After all, if we want more risk, why not just increase our exposure to stocks? That's why we invest most of our fixed income in high-grade, government-guaranteed bonds. This strategy ensures that money will be available when we need it.

To invest in bonds, we usually use what we call a *bond ladder*. That means having the bonds come due every year or so. For example, a five-year bond ladder will have bonds coming due in each of the next five years. So, your maturities are spread out and you have money coming due each year. In a year's time, the first bond will come due and you will have four bonds remaining. Then we will re-invest the proceeds into a new five-year bond to re-establish the ladder.

This strategy has several advantages:

1. You have regular liquidity with bonds coming due every year.
2. Your bond maturities are spread out for diversification.
3. Your new purchase will be a five-year bond, which usually offer higher yields than shorter-term bonds.
4. Your decision-making is easier because you have a plan.

Using a bond ladder is a simple and effective solution to protect us from interest rate changes. This will help us get better returns over the long term. ■

Elaine Loo is an Associate Investment Advisor for the Stan Clark Financial Team at CIBC Wood Gundy. She is responsible for the day-to-day monitoring and maintenance of client accounts and investment portfolios.

CIBC Wood Gundy

The Stan Clark Financial Team
Where planning, investing and behavioral finance meet

Phone: (604) 641-4361 Toll free: 1 (800) 661-9442 Fax: (604) 608-5211 Email: StanClarkFinancialTeam@cibc.ca www.stanclark.ca

Stan Clark is an Investment Advisor with CIBC Wood Gundy in Vancouver, BC. The views of Stan Clark do not necessarily reflect those of CIBC World Markets Inc. This information, including any opinion, is based on various sources believed to be reliable, but its accuracy cannot be guaranteed and is subject to change. Clients are advised to seek advice regarding their particular circumstances from their personal tax and legal advisors.
If you are currently a CIBC Wood Gundy client, please contact your Investment Advisor. CIBC Wood Gundy is a division of CIBC World Markets Inc., a subsidiary of CIBC and a Member of the Canadian Investor Protection Fund and Investment Industry Regulatory Organization of Canada.