The Basics of Investments

Guaranteed Products

Guaranteed Interest Accounts (GIAs) are the insurance company equivalent to Guaranteed Investment Certificates (GICs) found at banks or credit unions. You can choose to invest from time periods of one, three or five years. As investments mature at the end of their term, they are re-invested back into the same term at the new interest rate or invested according to the instructions you provide us.

GIAs are redeemable prior to maturity, but a market-value adjustment will occur. This means that the amount available to you may be adjusted upward or downward to reflect the current market for interest rates of similar terms as compared to the original interest rate.

The volatility level of guaranteed products is low.

Money Market Funds

Money market funds invest in short-term interest bearing investments such as Treasury bills, commercial paper and short-term government bonds. They offer a high degree of safety but the potential return is lower, usually not much higher than the inflation rate. While the risk is low, money market funds, like all market-based investment funds, are not guaranteed. Rapid increases in interest rates could decrease the value of the fund. Use this type of fund if you want short-term liquidity and low risk for your investments. Investors often choose to “park” their money in a money market fund while deciding where to invest for the long term.

The volatility level of money market funds is low.

Bond Funds

Bond funds, also called fixed-income funds, are designed to generate a steady stream of income in combination with the safety of the face value. The fund invests in debt securities issued by governments and corporations.

Bonds can be categorized in three ways:

1) Short-term: matures in less than 1 year;

2) Medium-term: a term of 2–10 years;

3) Long-term: a term of more than 10 years.

It is important to note that bond funds do fluctuate in value. Generally speaking, when interest rates go up, bond funds go down. Naturally, the reverse is also true. Therefore, bond funds can potentially provide negative returns. Their degree of volatility is related to how much interest rates move up or down. When you invest in a bond fund, instead of buying just one bond you have the advantage of buying a portion of a collection of different bonds, which are bought and sold by experts who manage the fund to maximize its return for investors.

Ratings are a critical consideration when a fund manager invests in bonds. Ratings provide a picture of the issuing company’s or government’s ability to repay the debt. Bonds rated AAA are the highest quality, while bonds rated BB and below are considered speculative or “junk bonds”.

The volatility level of bond funds is medium.

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Canadian Equity Funds

In a Canadian Equity Fund, the fund manager invests primarily in the common shares of publicly traded companies. Equity funds tend to outperform money market and bond funds over the long term. However, this higher potential for returns is offset by a higher degree of risk. Prices of equity funds tend to fluctuate more widely than money market or bond funds and are therefore considered more risky.

The primary objective of equity funds is to provide growth through capital gains and dividend income.

Some Canadian Equity Funds will also invest in foreign equities depending on the strategy of the fund.

Equity fund managers use different methods, called management styles, to manage their funds. Some invest in the biggest companies, often referred to as "blue-chip" companies, while others are willing to invest in smaller, growing companies in the hopes of better returns. You should review the management style of a fund to ensure it matches your tolerance for risk.

Fund manager style is discussed in section called "Making Sense of Fund Manager Style". The volatility level of Canadian equity funds is high. For Canadian equity funds that invest primarily in small capitalization funds, the volatility level is very high.

Dividend Funds

Dividend funds invest in preferred shares as well as high-quality, blue-chip common shares that have a history of consistently paying dividends. Dividend funds are historically considered riskier than bond funds, but less risky than pure equity funds. The income from dividends is currently taxed at a better rate than straight interest income. This tax advantage is not important while you are saving in a registered savings or pension plan as income grows tax-deferred, but will be important if you are saving in a non-registered plan.

The volatility level for dividend funds is medium to high.

Foreign Equity Funds

Foreign equity funds invest in common shares of non-Canadian companies. Canada represents about 4% of the world's equity markets so, it's wise to think about diversifying outside the Canadian marketplace to take advantage of investment cycles in foreign markets.

Global equity funds can invest anywhere in the world, including Canada. International funds typically invest outside of North America. Some funds are specific to the country or region they invest in such as a U.S. Equity Fund.

The primary objective of equity funds is to provide growth through capital gains and dividend income. Equity funds tend to outperform money market and bond funds over the long term. However, this higher potential for returns is offset by a higher degree of risk. Prices of equity funds tend to fluctuate more widely than money market or bond funds and are therefore considered more risky.

The volatility level for foreign equity funds is high to very high.

Balanced Funds

Balanced Funds, also known as Diversified Funds, invest in a mix of stocks and bonds. The main investment objective of these funds is to provide a balanced mixture of safety, income and capital appreciation. The fund manager will hold a portfolio of bonds for stability and income, and a diversified group of common stocks for

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diversification, dividend income and growth potential. Managers adjust the percentage of each part of the portfolio in accordance with current market conditions and future expectations. The benefit of a balanced fund is that it provides diversification by investing in both bonds and stocks. If either stocks or bonds perform poorly, your risk is reduced as the stronger performer may offset the poorer investment.

The volatility level for balanced funds is medium to high.

Asset Allocation Funds

Asset Allocation Programs are a lot like Balanced Funds. They invest in a mixture of stocks and bonds and go one step further by looking at your individual risk tolerance. To participate in an Asset Allocation Program, you complete an Investor Profile Questionnaire that directs you to the proper fund to invest in. The most appropriate fund is the one that has the asset mix that matches your investor personality and tolerance for risk.

The asset and fund mix that is most appropriate for you is sometimes called your “target mix.” Asset allocation programs offer the advantage of automatic re-balancing. This means that as stocks and bonds grow at different rates, and your personal asset mix therefore changes, your portfolio is automatically adjusted to bring you back to your target asset mix. If you are looking to take a “hands-off ” approach to investing and letting someone assist you with asset class selection, fund manager selection, and monitoring, then this product may be right for you.

The volatility level for asset allocation funds will vary based on the fund selected (from low to very high).

Target Date Funds

Target Date Funds are also known as Life Path, Life Cycle or Life Plan Funds. They are a lot like Balanced Funds and are designed for investors who want to take a “hands-off” approach to investing. The funds invest in a mixture of stocks and bonds that change over time based on the length of time to your anticipated retirement date.

There is no investor profile questionnaire to complete. To participate in a Target Date Program, you simply identify the year you expect to retire and select the fund that is closest to that year. For example, an investor who is 39 years old in 2017 and wants to retire at age 60 has a long term horizon before retirement. Her expected retirement date is the year 2038, she would either pick 2035 or 2040 Fund as her investment mandate. The further out the retirement date, the more equity the fund holds and therefore the higher risk. By way of contrast, investors who are within two years of retiring would select the Retiree fund as their investment mandate. As the retirement date approaches, the fund manager automatically makes the fund less risky by investing in more conservative investments. The main objective is to reduce portfolio risk as the individual’s investment time horizon shortens.

The volatility for Target Date Funds will vary based on the fund selected (from low to very high).

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