Investing For Me

The science of investing.

Bank of Nova Scotia 3.05% GIC Maturity **27-Jun-2013**

Each sample investment portfolio held a Bank of Nova Scotia GIC maturing on June 21, 2013. Both the GIC's principal and final interest payment were credited to each portfolio's account cash balance.

The GIC was originally purchased on June 21, 2010 as part of our initial bond maturity schedule – this GIC represented the 3rd year of a maturity schedule/ladder that ranged from 1 to 9 years. *(Our original 9-year maturity is now our 6-year maturity, yielding 4.16%.)*

At the time of purchase, a 3-year GIC offered a much better yield to maturity than any comparable regular bond with the same maturity.

What is your plan for the account's cash balance?

Each of our sample investment portfolios maintain a cash balance, which typically represents the dividend and interest income earned by the investments held.

The current account balances also include the GIC maturity proceeds and accrued interest.

The cash balances require two investment decisions

1. Reinvest the proceeds from the maturing GIC and
2. Invest the account's remaining cash balance.

Note: The discussion that follows deals with the reinvestment of the maturing GIC. An investment decision for the account's remaining cash balance will be made in the coming weeks.

In reviewing the sample portfolio and remembering the maturing GIC formed part of the portfolio's fix-income foundation; we have focused our research on fixed income investment options – GICs, bonds and preferred shares.

What did you buy?

Before we begin exploring investment options we always like to reread the portfolio's Investment Policy Statement (IPS) and the IFM investment approach. *Why? Because it helps us to focus only on investments options identified by the IPS - saving us time and maximize our research efforts.*

Note: By rereading the portfolio's IPS it makes our research job so much easier. As most of you know, there are thousands of investment options and thousands of investment opinions out there. Reviewing the IPS helps us to filter out all of the investment *noise* and only focus on the options that fit with the IFM investment approach and the portfolio's IPS. *(A written IPS not only helps to guide our decisions, but it also gives us permission to ignore investments that don't fit for us. What a huge savings in time and effort?)*

The recent rise in interest rates has caused bond and preferred share prices to decline - increasing the attractiveness of preferred shares and, for the first time in years, bonds now offer a more attractive yield when compared with the interest rates offered by GICs.

We first considered buying another preferred share in each portfolio *(with their great 5.0% to 5.65% dividend yields)*, but we already have a very healthy investment in preferred shares, which currently represents approximately 20% in each portfolio – already at the top of the 20% maximum set out in each portfolio's IPS. (*Having a written IPS just saved us the effort of researching preferred!)*

Note: Sometimes sticking to your IPS is hard. As investors, we sometime see what we think are great opportunities and we are eager to jump on them. But if you are ignoring your IPS in the process, then you are heading into no-mans' land – where no rules exist and anything can happen – *good luck!* When deciding between preferred shares and bonds we need to remember preferred share prices are more volatile than those of bonds as interest rates fluctuate. So while increasing the portfolio's investment income is a top priority, we cannot ignore the risks of market price volatility. Risks to our saved capital are a big consideration when creating our IPS and making investment decisions.

Eliminating preferred shares as an option, we turned our attention to bonds and GICs.

First, in reviewing each portfolio's current maturity schedule, our objectives for reinvestment were

- To replace the 3.05% annual interest income lost when the Bank of Nova Scotia GIC matured and
- To strengthen the maturity schedule by reinvesting in a bond/GIC that matures in 2018, 2020 or 2021.

Each portfolio maturity schedule has the majority of its fixed income investments maturing within the next 5 years. Thus, if interest rates were to rise, each portfolio is well positioned to take advantage of such a move. This gives each portfolio the ability to comfortably invest in longer maturities – 2020 or 2021.

By looking for investments that mature in 2020 or 2021 (7 and 8 years), GICs are eliminated as possible investment options.

Remember: GICs with maturing 6 years or longer are not insured by CDIC or most provincial insurance plans. So buying an uninsured GIC is the same as buying a regular bond without the flexibility to sell prior to maturity if you need to.

In these circumstances, we prefer to hold bonds.

After search the bond market for possible, available investment options, we decided to purchased a Bell Canada bond.

The bond
- Is issued by Canada's largest communications company
- The Dominion Bond Rating Service (DBRS) currently gives the bond a strong 'A(low)' credit rating.
- Matures on June 17, 2020 (7 years).
- Pays 3.25% each year in two equal installments – one in June and one in December.
- Was priced at $98.011, below par of $100, so no mater where interest rates and bond prices head we are confident in receiving all of our capital upon the bond's maturity. (See - *What does it mean to purchase a bond at a discount?*)
- Earns a semi-annual yield of 3.575% for each portfolio.

Are you happy with your decision?

Yes, we are happy with the Bell Canada bond. Purchasing this bond helped us to
- Replace and improve on the 3.05% interest income lost when the Bank of Nova Scotia GIC matured
- Strengthen each portfolio's fixed income maturity schedule by adding a 7-year maturity
- To maintain each portfolio's strong asset allocation and structure
- To remain true to the investment criteria and guidelines set out within each Investment Policy Statement.

Note: *We do not view the portfolio as a series of individual investments - independent from each other. While one investment may only contribute 2.25%, another investment might contribute 4.0%, 5.0% or more. So together they combine to provide our required rate of return.*

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